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MORTGAGE BANKING

NOVEMBER 1985

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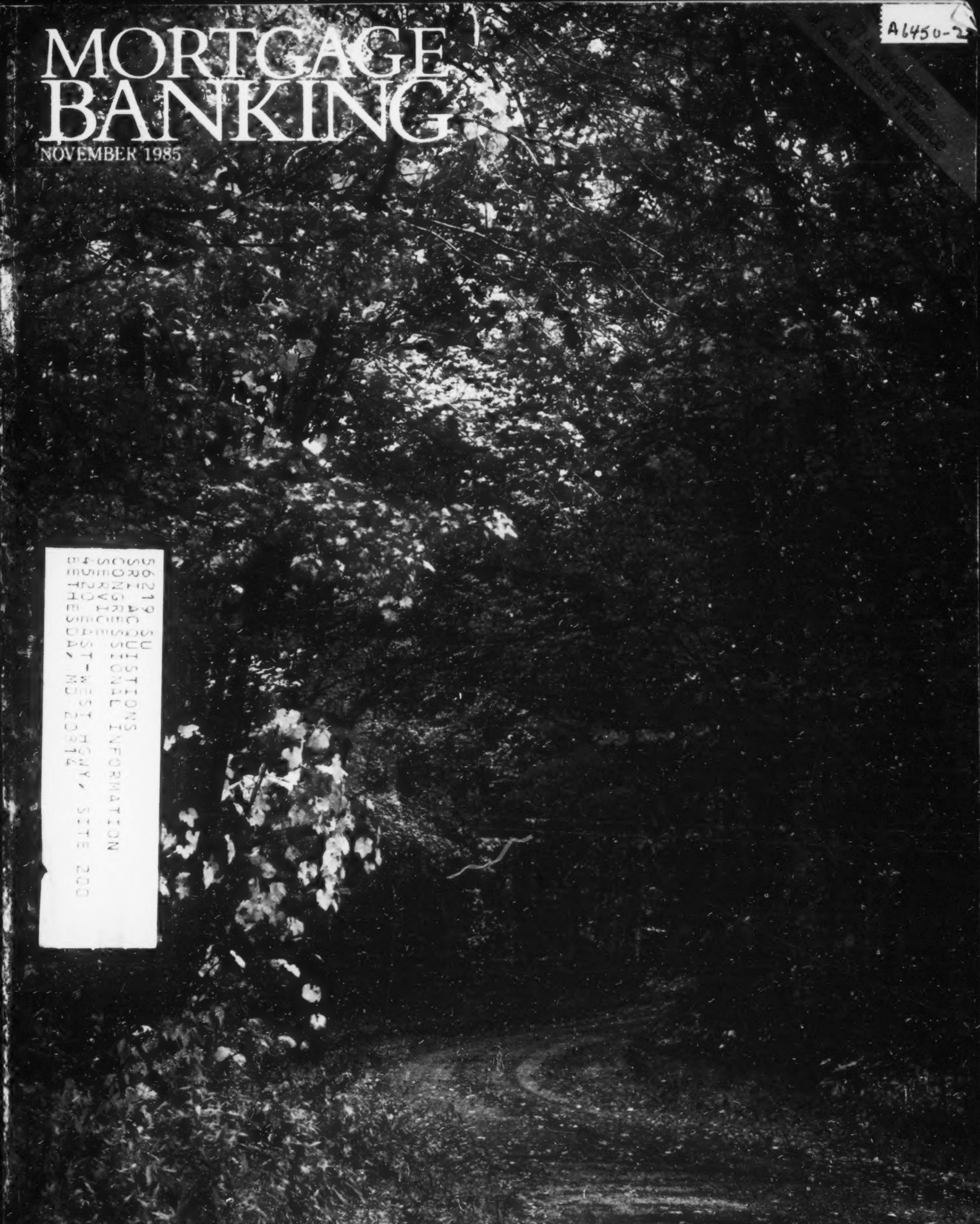

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MORTGAGE BANKING

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Newly installed MBA President Ron Poe outlines his major initiatives for the coming year in this candid interview. MBA will focus on internal and external quality control and launch the Comprehensive Educational Program, which will create an orderly curriculum for professional development through educational programs sponsored by the Association. Mr. Poe gives his views on the future of the real estate industry.

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PRICING MORTGAGE-BACKED SECURITIES IN THE FORWARD MARKET
Susan D. Mara
Forward delivery transactions in the mortgage-backed securities market can be useful and even profitable for the market participants involved. But this author points out the necessity to consider all of the factors involved that affect the implied cost of carry implicit in these trades and the sensitivity of this cost to the specific conditions of each transaction.

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MORTGAGE BANKING AUTOMATION: A MATURING INDUSTRY
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SMALL BUSINESS DEVELOPMENT AND THE ROLE OF THE MORTGAGE BANKER
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Small businesses do not have access to the long-term capital markets through ratable debt securities. Because their growth contributes significantly to national growth and the creation of jobs, the reduced availability of long-term credit for small business has major implications for the future of the nation's economy. The SBA developed Section 503 loan program to cope with the problems in obtaining long-term credit.

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THE LAST WORD (MORTGAGE PREPAYMENT PENALITIES DOWN BUT NOT OUT)
C. Duane O'Neal
The use of prepayment penalty provisions in mortgage contracts are becoming increasingly vulnerable to attack and criticism by courts and federal statutes. The author explains some of the factual and legal considerations that enter the equation to determine the legal liability of a lender to apply what appears to be a contractual right.

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MORTGAGE MARKET TRENDS

Continued strength in the housing sector, combined with an increase in the rate of inventory accumulation and possible improvement in the trade deficit, may generate moderately strong but not robust growth in the fourth quarter. The 3.3 percent annualized rate of growth of real GNP in the third quarter could carry over into the fourth quarter before tapering off somewhat in the first half of 1986.

The third quarter ended with a surge in retail sales. Seasonally adjusted, the September 1985 retail sales figure was 2.7 percent higher than the previous month and 10.9 percent over September of last year. Record auto sales, spurred by dealer discount financing, accounted for most of the growth. Excluding the automotive group, retail sales changed only slightly from August but were 4.8 percent above last year's level.

For several reasons, this burst of consumer spending is not likely to continue nearly as strong. Lower than normal auto sales can be expected after dealer discount financing, which induced many to move up their purchasing plans, is discontinued. Actually, the first 10 selling days of October saw an abrupt drop. In addition, the unusually low third quarter personal savings rate of 2.9 percent, (which was partly related to strong auto sales), together with consumer installment credit outstanding at a relatively high 15.9 percent of personal income, presage a pause in spending as consumers replenish their savings and pay off debts. However, consumers remain quite confident. They express strong buying plans in attitudinal surveys and they are relatively liquid so that no dramatic falloff in consumer spending is expected.

Inventory accumulation was negative in real terms in the third quarter, reflecting liquidation of auto stocks. Outside of autos, inventories are in reasonably good balance with sales. Therefore, rising inventory investment should be offsetting weak consumer spending.

The merchandise trade deficit, which exerted a persistent drag on economic growth in the first half, may now be in the process of stabilizing which third quarter statistics on GNP suggests. A major improvement in this sector cannot be expected until at least a year after a substantial decline in the value of the dollar occurs.

Business investment is likely to be weak in the near term. Nonresidential, fixed investment in real terms fell 4.7 percent in the third quarter at an annualized rate. Also, recent survey results indicating business' reduced spending plans for plant and equipment are borne out by the recent weak figures for contracts and orders for plant and equipment.

Inflation is not expected to worsen in the near term. Both the consumers and producers price indices have shown very moderate growth in recent months. The current move to lower the value of the dollar in international markets, if successful, will result in higher prices for imported goods. However, this is likely to be offset to some extent by an expected late winter decline in oil prices and strong productivity gains in the manufacturing sector. In addition, foreign producers may be willing to lower profit margins to maintain market share.

The Federal Reserve, which has followed an accommodative policy through much of the year, letting M-1 consistently exceed its target range since setting its new targets, is unlikely to tighten significantly until the economy shows clearer signs of sustained growth. Thus, interest rates are likely to remain near their present levels through the first half of 1986.

The housing sector, a source of strength in the economy over the course of the past year, is likely to remain relatively strong. Construction spending rose to $344 billion in August at a seasonally adjusted annual rate, a 7 percent increase over a year ago. While the general unemployment rate rose slightly in September, 40,000 jobs were added in the construction sector, sustaining a pattern of vigorous growth that totalled 370,000 over the year. Although housing starts fell 9 percent in September, building permits were up slightly, so that activity in housing is expected to remain near current levels.

Existing single-family home sales rose 9.2 percent in August to a seasonally adjusted 3.43 million units, their highest level since 1979. Even though new single-family home sales fell 6 percent from the higher than expected July figure, the 705,000 units sold at a seasonally adjusted annual rate still represents a strong showing. With contract rates on fixed-rate mortgages expected to remain in the 12 to 12.5 percent range into the second half of 1986, home sales are likely to continue their healthy pace.

Dr. Victor Cholewicki
Assistant Economist
October 17, 1985

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
APR	175	118	57	1,933	1,268	665	160	105	55	1,704	1,066	638
MAY	170	118	52	1,681	1,148	533	171	109	62	1,778	1,064	714
JUN	163	110	53	1,701	1,123	578	156	100	56	1,712	1,091	621
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	162	110	52	1,746	1,168	578	159	101	58	1,784	1,117	667
SEP$_P$	**145**	**96**	**49**	**1,583**	**1,042**	**541**	**166**	**93**	**73**	**1,796**	**1,066**	**730**
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
9 MONTHS												
1985	1,322	902	420				1,328	840	488			
1984	1,372	943	429				1,315	844	471			
1983	1,300	918	382				1,229	800	429			
1982	760	540	220				711	452	259			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
APR	26	22	80	48	293	247	874	519	24	22	71	43	258	223	760	463
MAY	25	29	72	45	237	257	744	443	28	27	72	45	267	263	784	464
JUN	27	27	67	42	284	239	737	441	26	25	64	42	275	254	743	440
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	25	66	44	230	241	751	524	25	25	65	44	266	259	770	489
SEP$_P$	**24**	**23**	**60**	**38**	**224**	**229**	**693**	**437**	**26**	**24**	**65**	**51**	**251**	**227**	**754**	**564**
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
9 MONTHS																
1985	182	181	596	363					198	180	576	374				
1984	146	187	692	347					148	162	642	364				
1983	129	166	712	293					125	143	664	298				
1982	84	107	425	144					75	91	386	157				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in millions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
MAR	263	67	357	6.3	$196,047	$81,549	$29,286	$85,212	1,020	602	418	125	83	42
APR	283	60	354	6.7	203,684	84,000	28,500	91,184	1,088	643	445	127	91	36
MAY	297	65	355	6.4	201,472	83,676	28,360	89,436	1,089	644	445	132	85	47
JUN	297	65	355	6.1	198,405	82,926	29,233	86,246	1,075	634	441	164	108	56
JUL	311	62	354	5.8	199,249	83,583	29,531	86,135	1,073	637	436	146	100	46
AUG$_P$	**332**	**59**	**353**	**5.8**	**202,403**	**84,636**	**30,057**	**87,710**	**1,089**	**648**	**441**	**153**	**102**	**51**
1983 TOTAL	2,719	623										1,393	1,021	372
1984 TOTAL	2,868	639										1,653	1,139	514
8 MONTHS														
1985	2,166	481										1,087	733	354
1984	2,034	451										1,064	730	334
1983	1,873	430										841	610	231
1982	1,335	262										630	441	189

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1984										
OCT	$23,075	$ 3,700	$ 9,643	$ 8,806	$ 926	$ 15,217	$ 3,110	$ 7,188	$ 4,813	$106
NOV	21,562	3,370	9,219	7,818	1,155	13,639	3,090	6,445	4,060	44
DEC	28,852	5,250	10,619	9,414	3,569	15,873	4,090	6,914	4,789	80
1985										
JAN	20,183	4,004	7,922	7,323	934	13,591	3,894	5,722	3,927	48
FEB	20,961	4,273	7,941	7,351	1,396	12,944	3,717	5,618	3,555	54
MAR$_P$	**25,406**	**4,333**	**10,681**	**8,350**	**2,042**	**16,517**	**4,037**	**7,887**	**4,502**	91
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55.680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
3 MONTHS										
1985	66,551	12,610	26,544	23,025	4,372	43,052	11,648	19,227	11,984	193
1984	65,350	13,870	25,697	22,966	2,817	42,702	11,310	18,977	12,240	175
1983	54,173	15,070	17,955	18,322	2,826	38,616	12,910	13,977	11,577	152
1982	25,465	4,920	8,170	10,204	2,171	16,199	3,630	6,698	5,774	97

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1984										
OCT	$ 1,341	$ 0	$ 880	$ 373	$ 88	$ 6,517	$ 590	$ 1,575	$ 3,620	$ 732
NOV	1,664	0	1,098	455	111	6,259	280	1,676	3,303	1,000
DEC	2,488	80	1,488	488	432	10,491	1,080	2,217	4,137	3,057
1985										
JAN	1,228	36	691	399	102	5,364	74	1,509	2,997	784
FEB	1,830	378	923	396	133	6,187	178	1,400	3,400	1,209
MARp	**2,020**	**170**	**1,162**	**511**	**177**	**6,869**	**126**	**1,632**	**3,337**	**1,774**
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
3 MONTHS										
1985	5,079	584	2,776	1,307	412	18,420	378	4,541	9,734	3,767
1984	5,886	1,260	2,729	1,609	288	16,762	1,300	3,991	9,117	2,354
1983	3,739	890	1,589	1,050	210	11,818	1,270	2,389	5,695	2,464
1982	1,589	380	621	457	131	7,677	910	851	3,973	1,943

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1984										
OCT	$ 19,331	$ 3,910	$ 10,578	$ 3,349	$ 1,494	$91,118	$8,370	$50,624	$18,288	$13,836
NOV	20,830	3,430	11,549	3,317	2,534	93,002	8,190	51,651	17,957	15,204
DEC	22,227	5,480	10,872	3,810	2,065	91,761	8,700	50,483	18,695	13,883
JAN	n.a.	n.a.	9,207	3,548	1,593	n.a.	n.a.	49,556	16,711	14,123
FEB	n.a.	n.a.	10,564	3,624	2,665	n.a.	n.a.	50,899	16,994	15,631
MARp	**n.a.**	**n.a.**	**14,217**	**7,831**	**2,806**	**n.a.**	**n.a.**	**53,175**	**21,748**	**14,496**
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
3 MONTHS										
1985	n.a.	n.a.	33,988	15,003	6,934					
1984	63,169	13,930	32,604	10,884	5,751					
1983	54,901	21,130	23,117	7,086	3,568					
1982	24,721	10,150	8,452	4,437	1,682					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1985												
MAR	168	65	16	87	91	$ 5,824	27	$ 1,504	13	$ 826	51	$ 3,494
APR	188	67	19	102	110	7,103	35	2,007	14	944	61	4,152
MAY	189	70	19	100	98	6,429	20	1,185	13	868	65	4,376
JUN	192	80	19	93	112	7,330	36	2,118	14	961	62	4,251
JUL	218	93	24	101	96	6,558	11	656	16	1,104	69	4,798
AUGp	**216**	**88**	**25**	**103**	**114**	**7,646**	**28**	**1,644**	**19**	**1,275**	**67**	**4,727**
1983 TOTAL	1,921	777	261	883	1,302	79,469	367	19,141	283	17,965	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,345	86,777	200	10,644	199	12,730	946	63,403
8 MONTHS												
1985	1,452	578	152	722	790	51,652	187	10,819	114	7,569	489	33,264
1984	1,287	285	143	859	972	62,641	155	8,273	149	9,577	668	44,791
1983	1,382	593	244	545	780	46,405	240	12,000	174	10,894	366	23,511
1982	553	195	81	277	337	18,265	64	2,792	57	3,280	216	12,193

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1985										
MAR	$ 1,636	$ 2,256	$39,370	$ 1,087	$ 3,580	$ 3,453	$ 3,232	$ 3,115	$ 3,757	$ 2,772
APR	1,921	1,515	40,952	1,856	4,672	4,141	2,201	1,973	2,230	2,558
MAY	2,074	1,703	41,613	1,004	3,375	3,701	3,591	4,240	6,073	3,595
JUN	1,593	1,904	42,755	1,519	4,101	5,172	4,106	3,281	3,324	3,609
JUL	1,583	1,918	43,891	1,527	2,714	3,258	4,626	4,385	9,086	3,859
AUG	**1,797**	**1,921**	**45,668**	**2,207**	**3,154**	**3,958**	**3,602**	**2,685**	**5,872**	**4,153**
1983 TOTAL	18,606	17,558	—	13,081	30,921	32,846	22,952	21,376	70,461	50,495
1984 TOTAL	21,008	16,722	—	13,546	30,743	32,601	21,885	20,489	36,101	27,859
8 MONTHS										
1985	13,798	14,718	—	11,933	27,988	31,569	26,802	24,088	39,097	25,900
1984	13,320	11,231	—	8,811	17,153	18,166	11,380	10,451	24,641	19,962
1983	11,517	11,559	—	10,090	21,815	23,168	14,831	14,119	51,394	36,087
1982	13,349	7,821	—	6,522	20,192	20,180	14,080	14,063	16,352	9,149

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA Mandatory Delivery Yields		
	FHA NEW[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	ARM (5 yr. Treas.)	Conv.	
1985								
APR	12.97%	13.01%	13.01%	12.05%	12.11%	12.525%	12.669%	14.16%
MAY	12.28	12.49	12.50	12.06	12.09	12.038	12.281	13.34
JUN	11.89	12.06	12.06	11.75	11.76	11.125	11.600	13.38
JUL	12.12	12.09	12.10	11.38	11.48	11.000	11.569	13.22
AUG	11.99	12.06	12.04	11.24	11.33	11.238	11.719	13.23
SEP$_p$	**n.a.**	**n.a.**	**n.a.**	**11.15**	**11.25**	**11.200**	**11.775**	**13.21**

CURRENT SECONDARY MARKET YIELDS

SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
APR	12.44%	—	—	12.75%	11.43%	8.31%	8.37%
MAY	11.89	—	—	12.25	10.85	7.65	7.83
JUN	11.20	11.20	11.23	11.62	10.16	7.09	7.35
JUL	11.26	11.30	11.27	11.64	10.31	7.20	7.56
AUG	11.39	11.38	11.42	11.77	10.33	7.32	7.72
SEP	**11.41**	**11.43**	**11.47**	**11.87**	**10.37**	**7.27**	**7.83**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
APR	22	101	—	—
MAY	3	104	—	—
JUN	25	104	104	107
JUL	35	95	99	96
AUG	22	106	105	109
SEP	**n.a.**	**104**	**106**	**110**

n.a.—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields

[5] Federal Home Loan Mortgage Corp. Existing Construction only

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year-to-date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**	**4,880**	**3,860**	**70**	**770**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

		1-4 Units				5+ Units			
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	**56**	**96**	**88**	**385,270**	**321,620**	**33,110**	**30,540**	**42,280**	**8,390**	**23,680**	**10,210**

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	**470**	**270**	**120**	**80**	**430**	**220**	**30**	**180**	**470**	**9,240**	**3,790**	**790**	**4,660**	**3,440**

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	**730**	**200**	**10**	**580**	**3,910**	**930**	**280**	**2,700**

Notes: [1] All dollar amounts are in millions.
[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.
[3] Series labeled non-residential are also inclusive of farm data.
[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.
[5] Year-to-date seasonally adjusted series not calculated.

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BRAVE NEW WORLD FOR MORTGAGE BANKING?

By Scott A. Shay

> *Dear Santa:*
>
> *It seems like everybody is trying to get into my business. I never dreamed that I would compete with automakers, department stores and can companies to originate mortgages.*
>
> *I know it's a lot to ask, but can you either make mortgage banking like it was or else please buy my company at a fat premium? I would be grateful.*
>
> *Very truly yours,*
> *A humble mortgage banker*

Many mortgage bankers view the onslaught of new entrants into the industry with the same ambivalence as the humble mortgage banker. Some mortgage bankers welcome the entrants because they provide opportunities to sell out or merge with larger entities. The fondest wish of many originators is to have a General Motors or Metropolitan Life as a parent to bankroll them. Further, such companies which are making a major push in a new industry, are frequently the best premium payers. At the same time, other mortgage bankers are gamely preparing to compete with the newcomers. They reckon that the experience and particular niches they possess will enable them to take market share from entrepreneurial firms suddenly bent, or broken, into the corporate acquiror's mold. However, these eager competitors are also seeking mergers and alliances with other mortgage bankers to bolster weaknesses that the corporate giants would be quick to exploit.

There are two principal scenarios for the industry's future. The first depicts dramatic consolidation in the industry. Subscribers to this scenario include many of the newcomers as well as a surprising number of traditional mortgage bankers. The second scenario depicts a future that is not much different from the recent past. Subscribers to the second scenario believe that the forces which have spawned diversity in the mortgage banking industry will continue to do so.

After discussing these two scenarios, some motivations behind some of the recent major mortgage banking acquisitions will be described. Throughout the discussion of the scenarios, the terms "new entrants," "mass originators," "mass marketers" and "corporate giants" will be used interchangeably. In the section, "The hopeful

ILLUSTRATIONS BY JIM STARR

megamortgage bankers," the important differences that make one group of new entrants very different from the other will be described.

Scenario 1—Fasten your seat belts

All three key components of mortgage banking—origination, secondary marketing and servicing—have been remolded by the development of an efficient mortgage securities market. All three are also susceptible to powerful economies of scale. Much has been written about the revolution in secondary marketing and the requirements of scale in the secondary markets, so the story will not be recounted here. However, just as fundamental, is that origination and servicing have also become scale businesses.

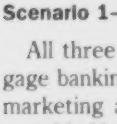
The most powerful force changing the origination business is the consumer's increasing price sensitivity. The volatile economic times of the 1970s and 1980s and the deregulation of interest rates on deposits of the 1980s has taught consumers that shopping for the best rates on financial products can be very rewarding. In response, mortgage bankers have competed ferociously with each other on interest rates and origination points. Whereas, mortgage bankers used to make money on originations, now they are typically content with profits from the subsequent servicing of the loan. As one mortgage banker put it, "We used to measure our up-front profits in points. Now, we count basis points." Indeed, the lexicon of originating has been altered. Now, mortgage bankers define success as breaking-even on originations so as to put "two-point servicing on the books."

With mortgage bankers largely willing to originate loans at break-even or at a small profit and with most moderately sized mortgage bankers looking at the same secondary market prices, the low cost producer of loans should be the winner. The question then becomes how to squeeze the costs out of the origination process.

Traditional mortgage bankers have taken several lines of attack. First, they have tried to rationalize their branch system to eliminate unnecessary expenses. Mortgage bankers have also started computerizing the origination process to make it more efficient. Although the savings in these areas have been impressive in absolute terms, they have tended to be relatively small compared to total origination costs. This is because personnel and particularly commission costs comprise such a large portion of origination expense for a traditional mortgage banker. The industry has also focused on the bulk producers of mortgage loans, such as builders, to reduce origination costs. Alas, the builders have taken back a lot of the mortgage bankers' gains through negotiation of the services and terms to be provided.

Some of the new entrants have determined to radically alter the way mortgages are originated in this country. The underlying theme has been to eliminate the commissioned loan originator based on the assumption that the consumer would prefer fewer origination points or a lower interest rate to personal "handholding." These newcomers often use advertisement and prequalification programs to reach the consumer before he or she has actually bought the home. Because there are neither loan agents nor branches to support, these programs typically charge fewer origination points or slightly lower rates. Consumers are basically offered a no-frills mortgage. Applications are taken by mail, questions are answered via a toll-free phone number and loans are closed through subcontractors such as title companies. Sponsors of these programs reason that homebuyers would rather know the mortgage they can carry before shopping for a house. Consumers have indicated in one study that prequalification programs reduce the stress of buying a home. The consumer knows that the agreed mortgage will be available so long as his or her application was truthful. Home sellers are also more comfortable with prequalified buyers because it is less likely that the sale will fall through due to financing problems.

The new entrants are also seeking other innovative low cost methods of targeting specific consumer groups. One of the increasingly popular methods is for mortgage bankers to align with corporations, trade unions, professional associations and other groups to offer mortgages. The mortgage banker then becomes the "official" originator of the group and can adver-



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Mr. Shay joined the firm in 1980 as an associate in the merger and acquisition group. He moved to the mortgage finance group in mid-1983 and was named vice president at the end of that year.

tise rates and services through the group's newsletters and other member communications. Managements of these organizations are enthusiastic about mortgage programs because they permit the group to offer a valuable service to its members, at little cost to the group. At the same time, mortgage bankers can offer cheaper mortgages because of reduced marketing and processing costs because these mortgages would also be handled by phone and mail.

These originators are pushing the "commoditization" of mortgages down from the secondary markets to the consumer. The same phenomenon struck the high cost liability gatherers, namely, banks and S&Ls, when the money market funds grew $141 billion from 1980 to 1982. While it may seem intuitive that consumers would want personal banking service, they have demonstrated a surprising willingness to entrust their life savings to post office box numbers. Similarly, the new entrants believe that the mortgage market will be very responsive to a mortgage-by-mail program if it proves cheaper for the homebuyer.

Yet the mass originators also do not want to originate for origination's sake. Instead, they are expecting loan servicing to provide profits. Servicing mass originations makes sense for several reasons. The most important benefit of mass originations is that it quickly builds a large portfolio of high balance loans. Servicing costs are very sensitive to volume as portfolio size exceeds $3 billion. Dr. Victor Cholewicki pointed out in "Servicing Costs: Putting the Pieces Together," August 1985, *Mortgage Banking* that servicing costs become vulnerable to diseconomies of scale at the $600 million level. This is probably true. However, what the study did not point out is that the diseconomies probably persist only until about the $2 billion level. Although no public aggregate data exists on the larger servicing operations, it is believed that at the $2 billion level, firms are able to restructure their servicing operations to utilize technologies appropriate for large scale data processing. Also, further dramatic economies of scale are available for portfolios exceeding $10 billion. This view of servicing costs results in a stepped cost curve shown in Chart 1.

Chart 1 implies that servicing is far more valuable to servicers of $10 billion or more enjoying marginal costs of servicing $30 per loan than to $1.5 billion servicers coping with marginal costs of $70 per loan. Servicing is worth more to the lower cost servicer because more servicing revenues fall to net income, which generates a higher net present value over the life of the serviced loans. Thus, given the same loan servicing fees, the larger servicer will be much more profitable.

Large servicers have a strong ad-

continued on page 15

CHART I

Marginal Cost of Servicing Per Loan
GROUPED BY DOLLAR VOLUME SERVICED

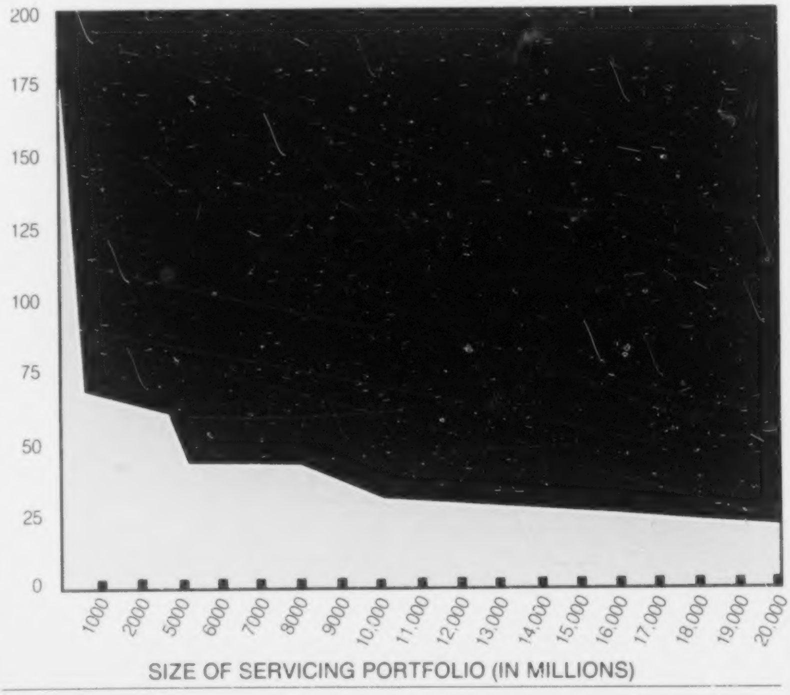


CHART 2

Top 100 Mortgage Servicers in the U.S.

Dollar Volume of Mortgages Serviced
(in millions)

Rank	1984	1983	1982	1981	1980	1979	Compound Growth Rate
1	$17,627.5	$18,113.2	$17,366.0	$11,736.9	$11,305.4	$10,559.5	10.8%
10	6,878.5	5,596.7	4,446.1	3,788.2	3,339.4	2,691.5	20.6
25	4,166.7	3,868.9	3,218.3	2,530.9	2,164.8	1,734.9	19.2
50	2,436.2	2,195.0	1,746.5	1,417.0	1,228.3	1,172.0	15.8
75	1,700.0	1,490.0	1,201.1	1,068.4	1,003.4	846.7	15.0
100	1,300.0	1,071.7	919.0	772.5	699.5	558.7	18.4

Source: *The American Banker*

Average Compound Growth Rate for Servicing Increase 1979-1984 16.6%

Compound Growth Rate of Total Residential Mortgages Outstanding 7.8%

vantage in reaching the far right corner of the curve depicted in Chart 1, in that they can also purchase servicing profitably. Purchased servicing provides both the benefit of lowering the servicer's new incremental costs as well as crucial tax benefits which permit the acquiror of servicing to shelter the servicing cash flows. Servicing acquirors enjoy an amortizable tax basis in purchased servicing that permits them to pay more for the servicing than it is worth to the seller. The reasoning is the same as for income producing real estate: the acquiror can use the depreciation of the purchase price to shelter income from the property. As a result, the property is worth more to the buyer than to the seller. Whenever an asset is worth more in the hands of a buyer than in the hands of a seller, it tends to encourage more transactions than otherwise.

Over the last year, we have witnessed unprecedented activity in the servicing transfer market as firms seek to acquire portfolios that will drive their expenses down the servicing cost curve. Chart 2 demonstrates that just to maintain relative position on the *American Banker's* Top 100 mortgage bankers list, firms had to add to their servicing portfolios at an average compound growth rate of 16.6 percent versus a compound growth rate of 7.8 percent in total mortgages outstanding. As both new entrants and traditional mortgage bankers increase their portfolios, the disparity between the value of servicing to the large servicers versus the small servicers will become even greater.

Certainly in such an environment, smaller servicers would have to reevaluate their competitive advantage. They would be producing servicing that had substantially less value to them than to their competitors. Even today, it is becoming clear to servicers that servicing is not worth two points to the originator unless it is sold, because the originator does not have an amortizable tax basis to shelter the servicing income. Therefore, coupling the economies of scale in servicing with the tax advantages of purchased servicing creates a powerful force for dramatic consolidation in servicing.

Proponents of this scenario argue that dramatic consolidation of the industry is consistent with the growing concentration of the rest of the financial services industry. They argue that the current structure of the mortgage banking industry results from the fragmented nature of depository institutions in the United States with over 18,000 banks and S&Ls. Just as depositories are consolidating as fast as law and regulation will permit, so will mortgage banks consolidate even more quickly because of the lack of legal barriers.

Advocates of this scenario contend that in 10 to 15 years, there will be 50 scale mortgage bankers, with 10 to 15 dominant firms heading the list. Such firms would be mass market originators with huge efficient servicing operations. Smaller mortgage banks would either be acquired by scale participants or would merge with each other to form larger economic entities. As the consolidation phase proceeded, prices for smaller mortgage banks would decline.

This scenario clearly calls for rapid action by mortgage bankers to either grow, merge, sell, or make sure that they have a niche that can withstand tremendous attack. It also means that those considering a sale of their company should do so sooner and not later. But take heart, there is an alternative forecast for mortgage bankers.

Scenario 2—Do not believe everything the Harvard MBAs tell you

Some mortgage bankers yawn at Scenario 1 and tales of massive consolidation. They make three key points: 1) originating loans by phone is not so easy for mortgage bankers or attractive for consumers, 2) servicing costs are not so susceptible to economies of scale, and 3) to the extent that alternative mortgage banking methods do take market share, it will come from the S&Ls and banks.

When a consumer is shopping for a mortgage, he or she is not likely to be as dispassionately rational as Scenario 1 would indicate. Most mortgage banking leads come from real estate brokers who have just signed a buyer to a purchase contract. Typically, the homebuyer is making his or her largest financial decision in a decade and is experiencing a variety of emotions, not the least of which is anxiety. It is at such a time that a personal touch is required. A homebuyer will naturally feel more comfortable talking to a local mortgage banker than dealing with a disembodied voice on an "800" number. Even if a buyer does check to see what rates the large entities are quoting, a resourceful loan originator can frequently coax the consumer back even if another firm has a slightly lower rate.

Subscribers to Scenario 2 are skeptical that servicing costs are really as sensitive to volume as Chart 1 indicates. They point to the advance findings of the Mortgage Bankers Association cost study that indicate that servicing costs flatten at the $600 million in servicing level.

Finally, there is the issue of where market share gains would come from if the mass marketers did have some impact. Traditionalists point out that mortgage bankers originate less than 30 percent of new residential mortgages (see Chart 3). In 1984, originations by mortgage bankers fell to 22.9 percent from 28.8 percent in 1983 due to teaser rates on ARMs being offered by S&Ls. Mortgage bankers' market share should bounce back in 1985 because fixed-rate loans have become more affordable and S&Ls have retreated from offering teaser rate ARMs. Thus, there is plenty of room for aggressive originators to take market share from banks and S&Ls. After all, mortgage bankers would argue, thrift and bank loan originators are less aggressive because they are not typically compensated on a commission basis and would, therefore, be the first to lose the consumer. It may be that thrifts and banks, which frequently have even higher cost structures than mortgage bankers, would suffer the most from new competition.

> **"The one thing a mortgage banker can be certain of is that the industry is undergoing dramatic change at an accelerating pace."**

continued

CHART 3

**Originations of Long-Term Residential Mortgage Loans
Percentage Originated by Selected Lenders
1-4 Units**

Year	Mortgage Bankers	Savings and Loans	Commercial Banks	Others (a)
1984	22.9%	49.4%	27.3%(b)	0.4%
1983	28.8	42.1	28.7 (b)	0.4
1982	29.4	36.7	24.5	9.4
1981	24.4	42.7	22.1	10.8
1980	22.0	45.7	21.5	10.8
1979	24.2	44.2	22.1	9.5
1978	18.6	48.6	23.7	9.1
1976	14.0	54.9	21.7	9.4
1974	19.3	45.8	23.9	11.0
1972	17.5	48.4	23.3	10.8
1970	25.0	41.6	21.9	11.5
1965	21.3	44.8	21.0	12.9
1960	19.3	50.9	13.2	16.6

a) Includes mutual savings banks, life insurance companies, and federal, state and local credit agencies
b) Due to lack of detailed information, figures for 1984 and 1983 include mutual savings banks
Sources: "The Secondary Residential Mortgage Market," *Salomon Brothers Bond Market Research*, April 1983 and "Lender Activity," *Mortgage Banking*, July, 1985

CHART 4

Selected Major Acquisitions of Mortgage Bankers
(Dollar Amounts in Millions)

Date Completed	Acquiror/Mortgage Banker	Price	Servicing Portfolio
06/83	Bank of Boston Corp./ Stockton, Whatley, Davin & Company	$120.0	$ 3,618
08/83	Mercury Savings Association/ Baldwin-United Combined Mortgage Company	100.0	4,429
12/84	Fleet Financial Group/ Bankers Mortgage Corp.	85.0	3,763
04/84	The Commonwealth Financial Group/Jersey Mortgage Company	30.0	1,968
08/84	Philadelphia Savings Fund Society/ First Anaheim	90.0	3,200
08/84	Paine Webber Inc./ Rouse Real Estate Finance	50.5	2,123
01/85	Pacific First Federal Savings Bank/Transamerica Mortgage Company	60.5	3,096
02/85	Owens-Illinois, Inc./ Alliance Mortgage Company	115.0	5,250
04/85	Integrated Resources Inc./ Wells Fargo Mortgage Company	108.0	6,241
04/85	Travelers Insurance Co./ Brokers Mortgage Service Co.	32.5	650
05/85	American Can Corp./ Berg Enterprises, Inc.	125.0	1,497
05/85	General Motors Corp./ Colonial Mortgage Services Co.	190.0	7,511
06/85	General Motors Corp./ Norwest Mortgage Inc.	125.0	10,266
08/85	Metropolitan Life Insurance Co./ CrossLand Capital Corp.	125.0	8,500
08/85	The Commonwealth Financial Group/General Electric Mortgage Corp.	55.0	3,000

Meanwhile, the scrappy mortgage bankers will hold their own.

Which scenario is right?

The answer is that they are both right, to varying degrees. The first scenario is correct in asserting that: 1) a mortgage banker's core value is in servicing, 2) innovative direct marketing of loans to consumers is far cheaper than traditional origination methods and at least a significant minority of consumers will respond to more attractive mortgage terms, 3) servicing costs fall dramatically at higher servicing volumes, and 4) the first three factors will lead to the creation of some servicing giants.

The second scenario also makes some unassailable points: 1) a significant number of consumers will always want and need personal attention through the mortgage application and approval process, 2) mortgage bankers are generally hard workers and will find profitable origination niches, 3) entities other than mortgage banks originate more than 70 percent of new mortgages and are the ones who really ought to be worrying about losing market share.

Putting all of this together leads to the conclusion that there will probably be fewer mortgage banks in the future than today, with origination volumes and servicing portfolio sizes far exceeding current averages. The top 10 servicers will probably be larger by a multiple of today's top firms, they will be national in scope, and quite profitable. There would probably be a second tier of 25 or so large regional or smaller national firms that would compete with the top 10 but would probably be less efficient and less profitable.

Finally, there would be a tier of perhaps 300 smaller firms that would successfully exploit niches of profitable originations and would supply the personal attention that some consumers would be willing to pay for. Many of these firms would sell their servicing to the larger servicers or would develop expertise in servicing particular types of loans (e.g. FHA Section 237 loans). We are already seeing the beginning of this trend as many smaller servicers have entered into correspondent relationships with larger mortgage bankers. Banks and S&Ls would

continued

see their share of originations shrink unless they can continue to successfully market loans such as ARMs, which are not attractive to secondary market investors but which can be held in bank and S&L portfolios.

This forecast presents mortgage bankers with several profitable avenues. They could attempt to grow to become megaservicers or strong regional firms through internally generated growth or by linking with merger partners. Intraindustry mergers may regain the popularity they lost in 1983 when outsiders began bidding up prices to gain entry to the industry.

Other mortgage bankers will focus on particular products or distribution niches. Some mortgage banks will link up with regional banks or S&Ls to create a regional presence, while others will enter joint ventures with real estate brokers. Many will become mortgage brokers selling their servicing on a flow (loan-by-loan) basis. Still, others will undoubtedly find a host of niches, as they examine the $200 billion origination market. Chart 4 lists the major mortgage banking acquisition transactions over the past two years. Chart 5 breaks the list down by depository and nondepository entrants.

CHART 5

Selected Major Acquisitions of Mortgage Bankers by Type of Acquiring Institution

Depositories

Acquiror/Mortgage Banker

Bank of Boston Corp./
Stockton, Whatley, Davin & Company

Mercury Savings Association/
Baldwin-United Combined Mortgage Company

Fleet Financial Group/
Bankers Mortgage Corp.

The Commonwealth Financial Group/
Jersey Mortgage Company

Philadelphia Savings Fund Society/
First Anaheim

Pacific First Federal Savings Bank/
Transamerica Mortgage Company

The Commonwealth Financial Group/
General Electric Mortgage Corp.

Nondepositories

Paine Webber Inc./
Rouse Real Estate Finance

Owens-Illinois, Inc./
Alliance Mortgage Company

Integrated Resources Inc./
Wells Fargo Mortgage Company

Travelers Insurance Company/
Brokers Mortgage Service Co.

American Can Company/
Berg Enterprises, Inc.

General Motors Corporation/
Colonial Mortgage Services Co.

General Motors Corporation/
Norwest Mortgage Inc.

Metropolitan Life Insurance Co./
CrossLand Capital Corp.

The hopeful megamortgage bankers

So far, all of the large acquirors of mortgage banks have been categorized under the rubric of the "new entrants." The situation is actually much more complex. In a sense, the nomenclature is a misnomer because almost all of the "new entrants" have entered the business by purchasing existing mortgage bankers. In some cases, acquirors have merely provided new capital, perhaps some complementary financial products and best wishes for continued profitability. Depository institutions have, for the most part, bought mortgage banks not to change the nature of the industry, but to regain the ground they have lost as efficient mortgage suppliers.

In considering the situation of the depositories in general and the thrifts in particular, it is not surprising that they have a keen interest in mortgage banking. Many thrift managers believe that liability deregulation has taken the profit out of mortgage spread lending. They reason that if they take into portfolio an adjustable rate loan that floats at 200 basis points over their cost of funds and if their operating expenses are 160 basis points (the national average), there is little after-tax profit. If a thrift attempts to fund a 30-year, fixed-rate loan on a duration matched basis, the best that can be hoped for is a 100-125 basis point spread, producing a loss after operating expenses. Therefore, many thrift managers reason, it is more sensible to build customer relationships by originating and servicing the mortgage loans but leaving the long-term funding to someone else. Also, the thrifts face a well-publicized capital shortage which makes them even more reluctant to leverage their scarce capital on low spread business.

Depositories enjoy an important advantage in mortgage banking over nondepositories through depositories' more efficient use of escrows. Mortgage banking subsidiaries of depositories can direct the mortgage escrow funds to their parent bank or thrift.

Thrifts and banks have made use of their mortgage banking customer relationships to cross-sell products such as credit cards, second mortgages, car loans and even deposits. PSFS, for example, offers a wide range of financial products through its thrift as well as its other financial service subsidiaries. As it focuses its three acquired mortgage bankers on cross-selling, it has tremendous potential. Commonwealth Financial of Texas has created an extensive mortgage banking network which has actually dwarfed its savings and loan operations. Yet the mortgage banking operations make the thrift more profitable by supplying escrows, as well as higher rate consumer loans appropriate for the S&L's portfolio. Fleet Financial Group is envied by many other banks because, among its other successes, it has built the fourth largest mortgage banking operation in the U.S. from an almost standing start. Many analysts believe that the primary reason that Fleet's stock tends to be valued by the stock market above comparable bank stocks is because of Fleet's mortgage banking presence and resulting off-balance sheet servicing values. Fleet has created an interstate network of financial services/mortgage banking offices that could give it an advantage in the interstate banking sweepstakes.

> "The future will be challenging for mortgage bankers of all stripes. No scenario analysis can accurately anticipate the pitfalls as well as opportunities that lie ahead."

Thus, depositories typically view mortgage banking as a more efficient means of delivering mortgages to consumers with the added benefits that it does not require use of their balance

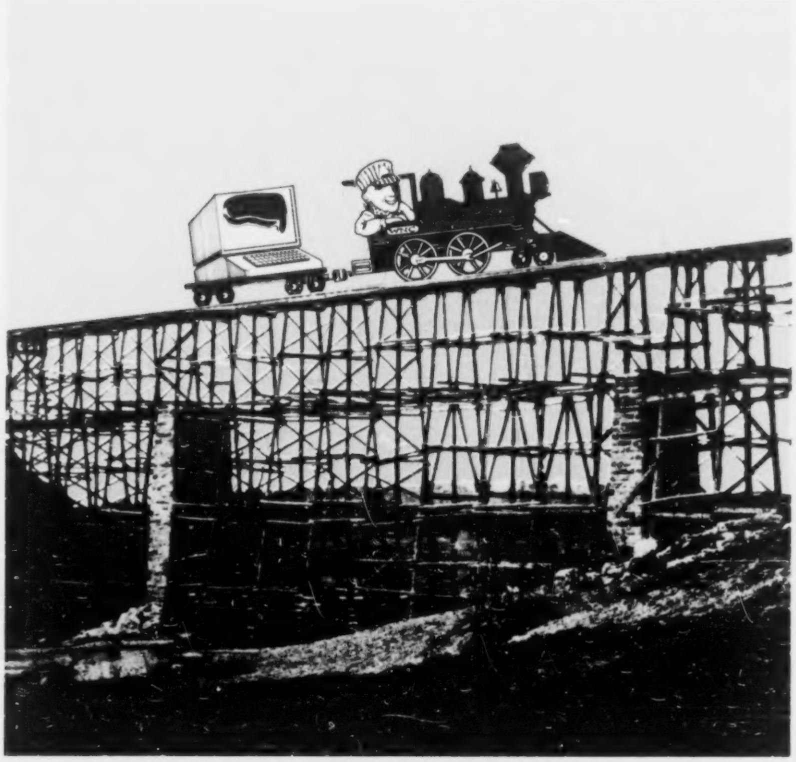
continued

sheets for long-term funding and it helps depositories regain mortgage market share that they have lost. Depositories' mortgage subsidiaries, on the whole, have competed on the same terms as other mortgage bankers and have not indicated an interest in radically changing their distribution methods through mass marketing efforts.

Nondepository entrants have generally had much more ambitious plans for their newly acquired subsidiaries. The nondepository entrants tend to view the mortgage market along the lines of Scenario 1 and, therefore, want to become very large very quickly. Metropolitan Life has already announced that it plans to harness the $35 billion of Century 21 gross real estate sales for its other recently acquired subsidiary, CrossLand Mortgage. Metropolitan must believe that it can bypass the commissioned loan originator by owning the real estate broker. Metropolitan also intends to offer other insurance and financial products through its Century 21 offices and through its nonCentury 21 mortgage servicing relationships. This approach to the business makes the consumer's real estate-mortgage relationship the linchpin of a much larger relationship. It is a very bold move. However, Metropolitan does face several challenges in executing its strategy. The biggest challenge is persuading all the independent Century 21 offices and independent contractor-brokers to cooperate. Unlike its own agency force, Metropolitan does not control the product (i.e., houses as opposed to insurance), which is the broker's core product and the biggest generator of his or her compensation. Without substantial incentives, Century 21 brokers will continue to focus on selling homes and not mortgages or insurance. Metropolitan will face a delicate problem balancing necessary incentives with cost effectiveness. If Metropolitan can successfully carry out the strategy, the combined entity could be an awesome force.

American Can's acquisition of Berg Enterprises, and indirectly, Berg's Margaretten and Company mortgage subsidiary, allows Margaretten to extend its foray into direct marketing. Even before the acquisition, Margaretten had begun prequalifying homebuyers for mortgages in certain K-Mart stores. Prequalification is a powerful tool that reaches the homebuyer before the Realtor. Margaretten is poised to substantially expand this effort with the expertise of another American Can subsidiary, The Fingerhut Companies, which has an excellent reputation for direct mail marketing. American Can can reach other potential customers through its insurance and mutual fund operations. Interestingly, another New Jersey-based mortgage banker, Brokers Mortgage Service, which was recently acquired by Travelers Insurance, has also made a major effort in direct marketing to the consumer.

No discussion of mortgage banking entrants would be complete without mention of General Motors' stunning back-to-back purchases of the servicing operations of Norwest Mortgage Company as well as its purchase of Colonial Mortgage Service Company, which combined, made GM the second largest mortgage banker in the United States. Much has been written about GM's potential in mortgage banking



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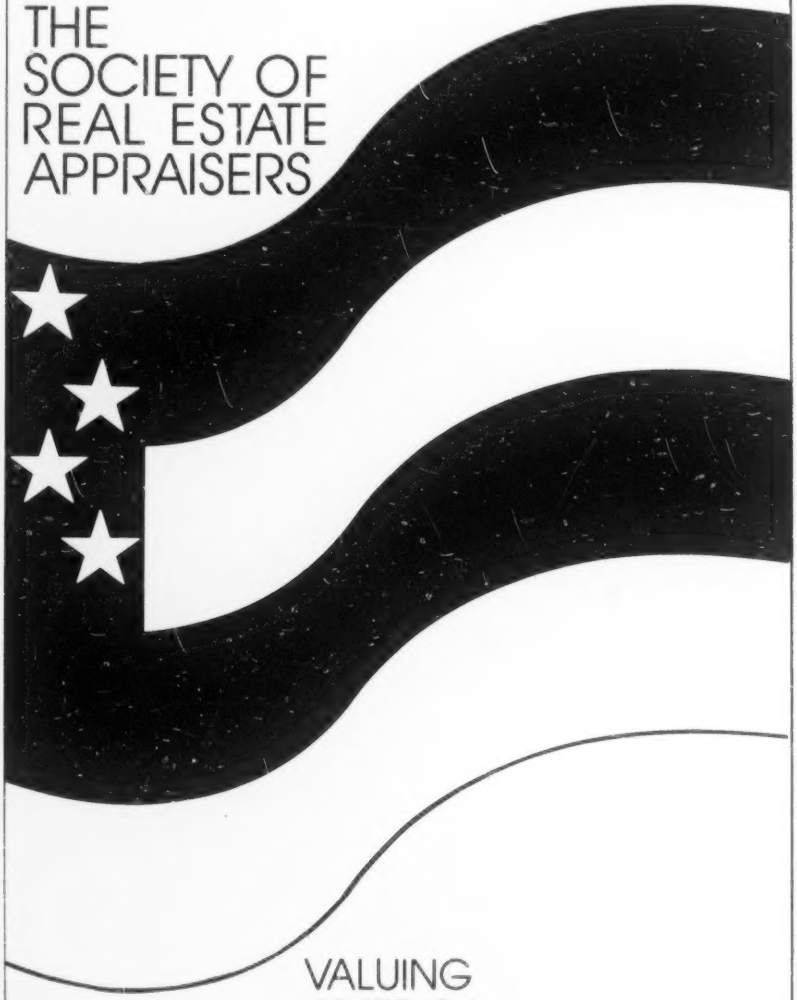

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which, through its subsidiary General Motors Acceptance Corporation, has $20 billion in mortgage servicing, $57 billion in consumer finance receivables and $4.6 billion in GMAC equity. Just its base of over 680,000 GM employees and 6 million GMAC customers will provide a formidable direct marketing base. GM's EDS subsidiary could also be a formidable asset for its mortgage servicing operations. EDS has a reputation for creating low cost data processing techniques for the financial services industries. GMAC clearly has the servicing mass to justify extensive technological improvements in current servicing methods. The question in mortgage banking circles is not whether GM has the potential to be a powerful competitor. Clearly it does. The real question is whether GM will fulfill its potential given what would seem to be such important and consuming distractions as its new Saturn operation, its Hughes acquisition and the fiercely competitive nature of the automobile market.

What is a mortgage banker to do?

The one thing a mortgage banker can be certain of is that the industry is undergoing dramatic change at an accelerating pace. The worst strategy is to simply ignore the tumult. Rather, mortgage bankers need to assess their competitive strengths and weaknesses. Companies with high servicing costs, but a good origination network might want to either restructure their operations, acquire an efficient servicer or merge with a superior servicer. Alternatively, such companies should consider selling their servicing on a flow basis and becoming mortgage brokers. Companies with strong servicing operations might find it profitable to linkup with a volume originator because originations are more valuable to a strong servicer. Some firms have all the competitive weapons but lack capital. These entities might seek financing from the public markets as well as from merger partners.

The future will be challenging for mortgage bankers of all stripes. No scenario analysis can accurately anticipate the pitfalls as well as opportunities that lie ahead. Mortgage bankers are uncommonly resourceful entrepreneurs and these times of change will be profitable for many. □

Nursing Home Investment:

GROWING OPPORTUNITIES

"He who refuses to embrace an unique opportunity loses the prize as surely as if he had failed."
William James
The Will to Believe

In recent years, growing numbers of institutional investors have allocated a portion of their investable funds to the financing of nursing homes and for the most part, have accumulated a trouble free portfolio at premium yields, secured by properties which have appreciated significantly in value. These few investors recognized a combination of forces, all of which point to a very strong market for nursing homes in the years to come and to increasing professionalism among nursing home operators to serve that continually growing market.

Factors *These forces include: ▪ The graying of America—the astonishing growth of the over-65 and the over-75 age categories representing the primary market for nursing homes. ▪ The increased personal wealth of the elderly which allows a significant proportion of nursing*

Nursing Homes *continued on page 28*

Stephen F. Wood, CMB

Nursing Homes *continued from page 26*

home patients to pay for the service from their own resources rather than using various government programs.

- The change in the Medicare reimbursement system regarding hospitals effective in 1983. The introduction of the Prospective Payment System (PPS) and its Diagnostic Related Groups (DRGs) have significantly shortened stays and reduced occupancy in hospitals, with many of these patients being discharged to nursing homes thereby increasing nursing home occupancy.

- The changing life-style of Americans reflected in the large number of households where both the husband and wife work full-time and the higher mobility of working families. This changing life-style dramatically reduces the ability of families to care for elderly parents at home.

- The strong trend among all states to reduce the population of mental institutions by early releases of mentally disabled individuals, many of whom are unable to adequately care for themselves and end up in nursing homes. In 1960, 805,000 persons representing approximately .44 percent of the national population resided in mental institutions. By 1980, this number had declined to 394,000 persons representing .17 percent of the population. Over the same time span, the population residing in nursing homes increased from 470,000 (.26 percent of the population) to 1,426,000 (.63 percent of the population). Similarly, the population in TB and chronic illness hospitals has declined from 1960 to 1980, indicating further transfers to nursing homes.

While these forces are operating strongly to increase the demand for nursing home beds, there are other forces at work at the present time which tend to limit the availability of new nursing home construction. The Deficit Reduction Act of 1984 placed a severe restriction on the use of industrial development bonds. Many new nursing homes had been constructed using the tax-exempt IDBs, but this source of financing is now much more difficult to obtain because of the more stringent restrictions. Additionally, in order to help contain reimbursement costs, primarily Medicaid, some 49 of our 50 states utilize the "certificate of need" process under which no new or expanded facility may be constructed without first obtaining a certificate of need from the state agency. Such certificates are increasingly more difficult to obtain in most areas. In fact, nine states have issued moratoriums on the issuance of certificates of need and more are leaning in this same direction in order to help control costs.

Economic opportunities

The obvious factors of an increasing demand for nursing home beds and a more restricted supply of such beds have not been overlooked by the business and investment community. Existing corporations engaged in the owning and operating of nursing homes have expanded significantly in recent years and many new corporations and limited partnerships have entered the business. The majority of nursing homes in the United States are still owned by individuals or small groups and this segment has been targeted by the professional, corporate and other multifacility operators for acquisition. Some major proprietary hospital corporations have entered the field or expanded their involvement in the nursing home industry.

An institutional investor engaged in the mortgage financing of income property has this attractive scenario:

The financing of nursing homes results in premium yields secured by facilities for which there exists an excessive market demand and limited supply, with virtual assurance that there will not be an "overbuilding" situation as exists with many other types of real estate. A well-managed nursing home will generate cash flow and can produce far better debt coverage than the more traditional real estate mortgages. Professional management is available with proven track records and there are ample sources of cash equity investment to further reduce the mortgage exposure.

This is an attractive scenario, particularly in an economy where an abundance of investable funds is still available and the more traditional types of real estate are becoming overbuilt in almost every major city.

Stephen F. Wood, CMB, is president of Equitable Mortgage and Investment Corporation, an independent mortgage banking firm in Nashville, Tennessee.

"Once fully occupied, a well managed nursing home will generate significant cash flow."

Given this attractive investment opportunity, let us examine the market in more detail. By far, the most compelling force is the amazing demographics. According to the American Health Care Association, 5 percent of the over-65 population live in nursing homes, while 25 percent of the over-85 population live in nursing homes.

Medical science may extend the average life span, but it has not necessarily resolved the medical problems that accompany greater longevity, hence, the great demand for nursing care.

The U.S. Bureau of Census estimates that population growth from 1980 to 2000 will average 16.5 percent for the total population. The 75-84 age group, however, will increase 47.9 percent, while the 85+ age group will increase 60.9 percent. A more detailed breakdown of this growth is shown in Table I.

Nursing homes are a relatively new phenomenon. Most were built after the late 1950s to care for people already receiving substandard care, or no care at all. Thus, there not only was a large immediate group to serve, but there was a rapidly expanding group of elderly adding to their numbers. As indicated in Table II, the average occupancy of nursing home facilities has increased steadily from 90.2 percent in 1969 to 94.7 percent in 1982. In many areas today, nursing homes are operating at virtually 100 percent occupancy with waiting lists.

In 1982, there were 19,500 nursing home facilities containing 1,500,000 beds for an average of 77 beds per facility. Of this amount, 20 percent of the total beds were operated by nonproprietary entities. Of the remaining 80 percent of the beds owned by proprietary entities, 79 percent were administrator-owned and available for acquisition and 21 percent were shareholder-owned. Since 1982, there has been a noticeable increase in professional multifacility operator activity in both the construction of new facilities and the acquisition of existing, administrator-owned facilities. This trend is expected to continue and to increase in intensity in the coming years and to significantly increase the price of existing facilities.

In its recent series on "The Elderly," the *Wall Street Journal* included the following comments in regard to capital needs.

"There is also the fear that, with the costs of building and running nursing homes rising so fast, someday not enough of them will be built to serve the people who really need nursing home care, unless those who don't need it are served in other ways. A recent federal study found that if present trends continued, the $23 billion a year that it costs to support nursing homes today would more than triple, to $76 billion, by 1990. Already, shortages of nursing home space in some areas mean that many elderly people must be kept in even more expensive hospitals until room can be found for them.

"Adding urgency to the whole problem is the fact that the sharpest rise in the country's elderly population is among persons 75 or older, a group especially vulnerable to such disabling illnesses as arthritis, heart disease and strokes. The National Institute of Aging expects that by the year 2000, the number of Americans 75 and over will have risen 53 percent since 1980, an increase almost twice that of the total 65-and-over group."

Recent statistics reveal that personal resources and family support provided 42.6 percent of the nursing

continued

TABLE I

Elderly Population Estimate, 1980-2000 (in millions)

Age Group	1980	1990	2000	Annual Rate of change 1980-1990	Annual Rate of change 1990-2000
65-69	8,780.8	10,006.3	9,110.2	1.3%	−0.9%
70-74	6,796.7	8,048.0	8,582.8	1.7%	0.6%
75-79	4,792.6	6,223.7	7,242.2	2.6%	1.5%
80-84	2,934.2	4,060.1	4,964.6	3.3%	2.0%
85+	2,239.7	3,460.9	5,136.3	4.4%	4.0%
Total	**25,544.1**	**31,799.1**	**35,036.1**	**2.2%**	**1.0%**

Source: U.S. Bureau of the Census, Population Estimates and Projections, Series P-25, No. 937, 1983

TABLE II

Growth of Nursing Homes by Year, Beds, Size and Occupancy

Year	Number of Facilities	Number of Beds	Average Size	Residents	Occupancy
1963	13,086	507,530	39	—	—
1969	14,998	879,091	59	793,074	90.2%
1973	15,737	1,175,865	73	1,074,480	91.4%
1978	18,722	1,348,794	72	1,240,373	92.0%
1982	19,500	1,500,000	77	1,400,000	94.7%

Source: Data from National Center for Health Statistics, Composite of Several Surveys, Department of Health and Human Services, Washington, D.C., AHCA estimates home receipts. Medicaid provided for 49.6 percent, with the remainder coming from miscellaneous sources including Medicare, health insurance, Veterans Administration, etc. Obviously, Medicaid, contributing almost half of the total nursing home receipts, is a significant factor.

Medicaid is a federal and state financed assistance program for needy and low income persons of all ages. States design their own programs within broad federal guidelines, resulting in variations from state to state. Medicaid pays for care for those who qualify in nursing homes certified as skilled nursing facilities (SNF) and intermediate care facilities (ICF). States are required to pay for these services at rates that are reasonable and adequate to cover costs incurred by efficient and economical facilities which provide care according to state and federal requirements. Each state develops its own formula for computing the rates paid to the nursing homes. States have the flexibility to restrain cost growth by developing nursing home reimbursement systems that include cost containment provisions and incentives for efficient operations, such as prospective payment rates and limitations on rates. An unlimited supply of nursing homes would strain a state's budget because it would create an unacceptable level of reimbursement. This situation could force the closing of facilities which would not be politically feasible. Therefore, fewer facilities for Medicaid dollars instead of less Medicaid dollars per facility may be the states' course of action in the near future.

The other important source of funds for nursing homes, individuals and families, provides the nursing home operator a greater margin of profits from the "private pay" patient. Individual facilities compete intensively for private pay patients by upgrading services and instituting cost efficiencies. This market is also expanding rapidly as indicated in a 1982 report published by FIND/SVP, the Information Clearing House, Inc. This report states that a solid 70 percent of the over-65 segment own their homes, of which 80 percent are mortgage free. Recent inflation in residential home prices has made this the single largest source of wealth among the elderly.

Also, the President's Council of Economic Advisors, in its most recent annual report, indicated that the source of income for the elderly has changed dramatically over the past three decades. The most important source of money for the majority of the elderly people today is social security, which, according to the report, accounts for about 40 percent of retirees' income.

Personal assets such as savings accounts, investments and private pensions account for 25 percent of retirees' income. Only a quarter of the work force was covered by pensions in 1950, but now half of all workers have them. In the future, more and more employees will fall under various pension plans.

The elderly have done relatively better in keeping up with rising prices in recent years than the population as a whole. Social security payments, tied by 1972 law to the rate of inflation, went up 46 percent in real terms since 1970, while wages and salaries of people still working withered by 7 percent. Prices increased 312 percent between 1950 and 1983, but the typical monthly social security payment jumped 905 percent.

The first economic law of supply and demand virtually assures that the long-term care industry will succeed financially in the immediate future. The nursing home will become the foundation for the community's care for the elderly. It will serve the patients from hospitals coming from one direction and residents from congregate care facilities coming from the other direction.

Given the irrefutable market forces indicating a favorable economic picture for nursing homes for years to come, what approach does the institutional investor take to participate in this financing market?

Costs

First, it must be recognized that there is a wide diversity of types of nursing homes, and that it is very difficult to come up with standard ratios which would fit all situations. Values of existing facilities might range from $15,000 to $18,000 per bed for a primarily Medicaid-oriented facility located in a small town and containing only intermediate care patients, whereas, values of $30,000 to $50,000 per bed may be indicated for an upscale facility catering primarily to private paying patients, including skilled care and located in a major metropolitan area.

> "The obvious factors of an increasing demand for nursing home beds and a more restricted supply of such beds have not been overlooked by the business and investment community."

Similarly, operating costs ratios vary significantly. An institution entering this financing market would be well advised to have a member of its staff and/or a loan correspondent who is totally familiar with the industry. Providing financing for an existing operating facility, perhaps upon acquisition by a new owner or expansion, is the safest way to enter the market. The historical operations of an existing facility can be scrutinized in some detail, with operating trends projected into the future, taking into consideration any particular changes that may be proposed by new professional management. Proposed new facilities offer more challenge. As with other types of real estate, the examination of comparable operations in the same geographic area provides the best indicator of future operations of a new facility, taking into consideration the proposed management skills, budgeting and marketing plan. Budgets should contain additional working capital to supplement the initial start-up.

Once fully occupied, a well-managed nursing home will generate significant cash flow. Usually, the debt service on a loan of 75 percent of the value (or acquisition cost for an existing facility) will be covered from 1.35× to 1.5× by the net operating income. In today's market, first mortgage loans on nursing homes will generally command a premium of 50 to 100 basis points over comparable first mortgages on more traditional types of real estate. Such yields might be comparable to those available in the financing of hotels and motels but without the risk of possible adverse effects such as economic recession, competition from overbuilding and changing highway patterns. In many cases, multifacility corporate or partnership entities provide significant financial strength to the transaction either by guaranteeing the indebtedness, or through a leaseback of the facility.

As institutional investors periodically review their real estate lending policies, they may wish to consider allocating a portion of their investable funds to the mortgage financing of nursing homes operated by professional operators. With proper management, which can be readily monitored and, to some extent, controlled by the lender, such facilities represent a safe investment secured by a product for which there is demand and limited supply. Additionally, premium yields can still be obtained from this segment of the mortgage financing spectrum. ☐

Elderly Lifestyles *continued from page 27*

fee for her new living arrangement. She does not want to pay any large upfront fees. She wants the option to change if, in fact, that is what she decides to do.

All of Mary Wainwright's desires can be satisfied by an Adult Congregate Living Facility (ACLF), also referred to by the Federal Housing Administration (FHA) as a Retirement Service Center (RSC).

How do we provide an ACLF for Mary Wainwright? Enter Jim Hentz, a builder/developer who has established an excellent track record building rental apartments. He is very interested in extending his product line and wants to seek markets other than moderate income apartments or condominiums. He is keenly aware that the elderly population in the United States is increasing at a startling rate and sees that the market for senior housing will be substantial for at least the next two decades.

Developer Hentz knows he has the skills to build rental apartments with the amenities required to keep sustained occupancy for moderate income tenants. He does not know, however, what he needs to do to meet the demands of the elderly or how to go about financing a project such as the one Mary Wainwright wants.

An ACLF or RSC can meet the demands of both Mrs. Wainwright and Mr. Hentz.

Criteria

What does the developer need do to pursue a project of this nature? The first step is to select a team. Developing and financing are a team process. A developer can only be as good as the team supporting him. The team must be knowledgeable, organized and compatible. It is extremely important to get as much of the team on board as soon as possible. Team members who are necessary include the following:

- *Developer*—The developer is the team leader, the one paying the bills and taking the risk. He must realize immediately that an ACLF is not simply real estate. It is a business. The majority of professionals today believe the strong builder/developer should subcontract an experienced managing agent who has an understanding of the elderly. A good service company who knows the restaurant business should also be subcontracted. Deep pockets and credibility in the marketplace are key elements for the developer.
- *Market analyst*—Identifying the market is a crucial first step. Many developers, including Oxford, have spent nearly a million dollars in research before doing their first project. Key factors in a demand or market analysis include location and income. Recent studies have shown that only 4 percent of people over the age of 65 move out of their home state. The market, therefore, is in every community in the United States. The ideal site, however, seems to be not more than 25 miles from the person's former residence.

Certainly, another very strong consideration in the demand analysis would be the income profile. The larger the population having an income of $30,000 a year or greater in a specific area, the greater the possibility for success of an RSC.

It is extremely important to use a credible market analyst who understands the market segment which the developer is trying to reach. The more credible the market research, the easier it will be to convince a lender of a real demand.

- *Managing agent*—The managing agent, above all others, is the key team member to have involved from the beginning. The architect may want to design a monument and the builder

continued

Michael J. Henderson is a partner with the investment banking firm of Newman and Associates, Inc., Denver, Colorado. He has served as the vice chairman of the Insured Projects Committee of the MBA and has been a member of the FHA and GNMA Liaison Committee. He currently serves on the Elderly Housing Committee.

James E. Crum

Servicing for Freddie Mac

QUALITY & QUANTITY

ILLUSTRATION BY DENNIS WALSTON

he Federal Home Loan Mortgage Corporation, (Freddie Mac) recently celebrated the 15th anniversary of its incorporation. Since it was founded, Freddie Mac's portfolio has grown to nearly 3 million loans serviced by more than 3,000 seller/servicers. The number of eligible loan products has steadily increased, as has the variety of purchase programs under which loans can be sold to Freddie Mac. This flexibility has assured seller/servicers a consistent market for their loans and a reliable source of servicing fee income to offset lean years on the origination side.

In this dynamic and often unpredictable environment, Freddie Mac's portfolio has demonstrated delinquency ratios and REO portfolio levels which are consistently below reported national averages. The quality of portfolio management performed by its seller/servicers is a major factor in achieving these results.

Education and sound principles

Effective servicing is an art that requires the practitioner to have a commitment to excellence, the flexibility to adjust to changing conditions and a sensitivity to the needs of individual borrowers as well as investor requirements. Freddie Mac tries to help its seller/servicers to acquire and refine these skills by providing sound servicing guidelines and requirements and ongoing education about Freddie Mac servicing policies and procedures.

Volume two of the Freddie Mac *Sellers' and Servicers' Guide* outlines the responsibilities of those who ser~~vice loans~~ on behalf of Freddie Mac. The *Guide* contains a recommended delinquency servicing program which stresses early contact with borrowers, assessment of the true causes of delinquencies and flexibility in structuring repayment plans which will result in the timely reinstatement of the loans. Property inspection requirements and prior approvals of foreclosures and deeds-in-lieu help ensure that seller/servicers have sought other alternatives before taking the costly step of commencing foreclosure. These underlying principles of sound delinquency servicing are supported through an ongoing educational program of seminars and workshops aimed at those people responsible for the daily activities related to Freddie Mac's portfolio.

Making the most of limited resources is another key factor in achieving success as a Freddie Mac seller/servicer. Wherever it is prudent to do so, Freddie Mac has delegated to its seller/servicers the authority to act on its behalf. Transfers of ownership, partial releases, insurance claim proceeds and cancellation of MI coverage are just some of the routine actions a seller/servicer can perform without prior approval, subject only to the conditions specified in the *Sellers' and Servicers' Guide.* In jurisdictions where it is permitted and where seller/servicer performance warrants it, Freddie Mac will grant a limited power of attorney to execute most documents which might otherwise require Freddie Mac execution.

Reporting to Freddie Mac is also simple. Delinquency reporting consists of just three basic forms each month, one of which is produced by Freddie Mac. Accounting reports can be transmitted electronically (except for certain transactions). Again, seminars and workshops are available to keep staff members current on Freddie Mac requirements.

Finally, the *Sellers' and Servicers' Guide* details administrative responsibilities for those servicing Freddie Mac portfolios. Mortgage file documentation requirements, note custody conditions, fidelity and E&O coverage guidelines and other duties are specified. These conditions of doing business with Freddie Mac reflect the need to properly identify, protect and service the nearly 3 million loans in which Freddie Mac holds an interest.

On-site review program

Freddie Mac monitors the performance of its portfolio and its seller/servicers using a variety of factors. The accuracy and timeliness of reports and funds remittances, the level of delinquencies by location and loan type, the number of REO properties held and the quality of servicing activities are a few of these factors. Freddie Mac also performs reviews of seller/servicer operations, including physical inspections of their records and vaults, discussions with managers and staff and verifications of the seller/servicers' delinquency and accounting trial balances against reports submitted to Freddie Mac. On-site reviews are conducted for both institutions with good servicing records as well as those whose performance indicates a weakness in one or more servicing responsibilities. By identifying problems early and working together, Freddie Mac and its seller/servicer can assure that the loans are properly serviced and that the institution maintains eligibility for a number of special benefits such as preferred seller status and special deal considerations.

"Effective servicing is an art that requires the practitioner to have a commitment to excellence, the flexibility to adjust to changing conditions and a sensitivity to the needs of individual borrowers as well as investor requirements."

James E. Crum is director of loan servicing for the Federal Home Loan Mortgage Corporation, Washington, D.C.

Previous to coming to Washington, D.C., Mr. Crum was regional director of loan servicing in the Northcentral region of Freddie Mac.

Chart 1 outlines the major problem areas identified during the on-site review program conducted the first half of 1985. Although 17 problems were identified during these reviews, four of them constitute 63 percent of the discrepancies noted. The four include:

- *Property inspections not conducted.* Freddie Mac considers property inspections to be an important element of a successful collection policy. Inspections must be conducted within the first 60 days of delinquency (90 days for FHA/VA loans), if there has been no agreement to a repayment plan. Monthly inspections are also required for all loans in the process of foreclosure and REO properties. These inspections provide an opportunity for face-to-face contact with borrowers, determination of occupancy status and property condition and are also important for determining if an abandonment has occurred which will trigger IRS reporting.
- *Mortgage files not identified.* All mortgage files, including separate collection files, insurance files and other records relating to mortgages sold in whole or part to Freddie Mac must be identified with Freddie Mac's loan number and percentage of participation. Notes securing mortgages sold in part to Freddie Mac must be identified with the Freddie Mac loan number on the face of the note. There are two reasons for this requirement. First, the seller/servicer protects itself from inadvertently pledging, hypothecating or reselling a loan in which Freddie Mac holds an interest. Second, Freddie Mac's staff will be able to quickly identify and deal with only those loans in its portfolio when it conducts an on-site review of the seller/servicer. In today's financial environment, this simple tool can prevent mistakes which might threaten a seller/servic-

continued

CHART 1

Freddie Mac Seller/Servicer On-Site Review Results 1/1/85 - 6/30/85

Property inspections not conducted	22.50%
Failure to properly identify loan files with FHLMC ownership, interest and/or loan number	19.17%
Overall collection procedures weak	13.33%
Incorrect monthly reporting	11.66%
Slow in reporting foreclosures to attorney	5.85%
Overall high delinquency rates	5.00%
No loan files on-site to review	5.00%
REO files unorganized and not up-to-date	4.17%
S/S referring foreclosures before receiving FHLMC consent	2.50%
S/S submitting *MI* reports late	2.50%
Overall servicing procedures inadequate	1.67%
S/S had transferred servicing and problems arose	1.67%
Notes incorrectly endorsed	1.67%
REO not disposed of efficiently	83%
Management or personnel turnover affecting performance	83%
Taxes not being paid as promised by S/S	83%
Foreclosure monitoring procedures inadequate	83%
	100.00%

er's relationship with Freddie Mac.

- *Incorrect monthly reporting.* In more than 13 percent of its reviews during the first half of this year, Freddie Mac discovered discrepancies between the seller/servicer's delinquency trial balances and the monthly reports filed with Freddie Mac. Most of these errors resulted from inadequate training of the people preparing the reports.

Freddie Mac defines a loan as being delinquent when any part or all of monthly payment of principal, interest and where applicable, escrow remains unpaid at the close of business on the day before its next scheduled due date. Thus, a payment due January 1 is delinquent one month if it is unpaid in whole or part (exclusive of any late charge) upon the close of business January 31. Other errors result from failing to notify Freddie Mac of a change in a loan's status. If, as an example, a loan is reinstated from foreclosure on the seller/servicer's books, but Freddie Mac is not informed of the reinstatement, an error in reporting will result.

> **"More than ever before, seller/servicers will need the 'right stuff' to achieve success in the dual goals of a growing portfolio and quality servicing performance."**

- *Overall collection procedures are weak.* Freddie Mac recommends a delinquency servicing program which deals with borrowers early in the delinquency. Lack of telephone contact with a borrower before the loan becomes 30 days past due or face-to-face contact before the 60th day of delinquency are common factors among seller/servicers with higher than average delinquency ratios.

Many seller/servicers enter into repayment plans with borrowers without a clear understanding of the borrowers' ability to meet their promises. Quality servicing of delinquent loans requires counseling, not merely collection techniques. Collection staff members must determine the cause of the delinquency in order to define the cure. While computer-generated payment reminders and form letters are useful collection tools, they cannot replace personal contact aimed at solving the borrower's problem.

Freddie Mac's on-site review program is designed to help seller/servicers identify operational weaknesses and to recommend specific actions which will improve their performance. Its goal is to develop a bond of cooperation and trust between Freddie Mac and its customers which will strengthen their relationship and expand their business opportunities.

Looking ahead

As Freddie Mac's portfolio continues to grow, the corporation will be looking for ways to make servicing its portfolio easier and more efficient. Among items under consideration is a new delinquency reporting system which will eliminate many of the forms currently required on a monthly basis. This new system would be integrated with the accounting reports and lend itself to automation via Freddie Mac's MIDANET® system.

Freddie Mac will also be expanding its on-site review program, both in terms of the number of reviews conducted each year and in the areas of activity to be checked. As the seller/servicer base and portfolio grow, the corporation will be concentrating its resources on those aspects of servicing which offer the greatest risk of loss. More than ever before, seller/servicers will need the "right stuff" to achieve success in the dual goals of a growing portfolio and quality servicing performance. These goals call for a competent staff, strong internal controls, effective policies and procedures and most important—the commitment to excellence. □

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MORTGAGE MARKET TRENDS

Following a lethargic first half, when real GNP grew only at a 1 percent annual rate, economic activity picked up modestly in the third quarter. The preliminary estimate for the rate of GNP growth in that quarter is 3.3 percent. Federal government spending increased sharply in the third quarter and consumer spending remained strong, led by increased purchases of automobiles. Continuing strength in the housing sector also provided some support.

Between July and September, federal government purchases of goods and services amounted to $347 billion at a seasonally adjusted annual rate. This represented about a 7 percent increase over the second quarter. Part of this increase was in defense purchases, which often bounce erratically on a quarterly basis. Purchases by the Commodity Credit Corporation also jumped in the third quarter.

Spurred by moderate rates of inflation in general and by cut-rate auto financing incentives specifically, consumer outlays rose vigorously during the third quarter. Led by robust automobiles sales, retail sales were up 2.3 percent in August and by 2.1 percent in September. Auto sales alone rose by almost 7 percent and 8 percent, respectively in August and September. Sales of nondurable goods also rose at a healthy pace. Both auto sales and total retail sales were down in October.

Growth in employment continued to be quite healthy in the third quarter. Despite the fact that the civilian unemployment rate has remained near its present level of 7.1 percent, the actual number of people who are employed has risen quite substantially this year. Through the third quarter, almost 1.7 million new jobs had been created and in October nonfarm payroll, employment rose by another 414,000.

In the housing area, continuing high levels of sales activity for both new and existing homes has been another positive component of economic growth. Existing homes are currently selling at an annual rate of over 3.4 million units, the highest level since November 1979. Sales of new homes, while not breaking records, are selling at close to an annual rate of 700,000 units. Housing starts, although unexpectedly weak in September, should return shortly to at least the 1.7 million unit level that prevailed as recently as August. Construction activity as a whole has also been strong, as evidenced by the 2 percent rise in construction spending in September, to a seasonally adjusted annual rate of $350 billion. The bulk of the rise in construction spending came in the nonresidential area, especially in office and other commercial buildings.

The continuing stability or slight declines in interest rates across a broad spectrum of short- and long-term maturities, including mortgage rates, has contributed to the strength of the housing sector and to the overall pickup in economic activity during the third quarter. Currently, short-term rates are averaging around 7.3 percent and yields on long-term government securities are approaching 10.5 percent. In addition, commitment rates on fixed-rate mortgages are averaging about 12.6 percent and for adjustable rate mortgages, they are about 10.6 percent.

In so far as the economic outlook is concerned, it would not be reasonable to expect consumer spending to continue at its recent pace. The personal savings rate is very low and consumer installment debt is now at a relatively high level. The contributions of consumer spending to overall economic growth, therefore, seem likely to diminish.

In addition, two recent surveys, one by McGraw-Hill Inc. and the other by Merrill Lynch, indicate that in 1986, business spending on new plant and equipment will rise relatively little, if at all. However, positive factors include rising auto production in the fourth quarter, continued high levels of federal government spending, particularly in defense and a lessened drag on the economy from the trade sector, as the impact of the declining dollar begins to take effect.

On balance then, over the next six to twelve months, we expect the economy to expand to an annual rate of between 2 and 3 percent, with growth leaning toward the lower end of the range through the Winter, then picking up somewhat, later in 1986. Based on this forecast, we anticipate that interest rates should remain stable or decline moderately over the near-term. This stability in interest rates should bode well for the housing sector, where sales and construction activity are expected to remain healthy through most of next year.

Robert Rosenblatt
Assistant Economist
November 15, 1985

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
APR	175	118	57	1,933	1,268	665	160	105	55	1,704	1,066	638
MAY	170	118	52	1,681	1,148	533	171	109	62	1,778	1,064	714
JUN	163	110	53	1,701	1,123	578	156	100	56	1,712	1,091	621
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	162	110	52	1,746	1,168	578	159	101	58	1,784	1,117	667
SEP$_P$	**145**	**96**	**49**	**1,583**	**1,042**	**541**	**166**	**93**	**73**	**1,796**	**1,066**	**730**
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
9 MONTHS												
1985	1,322	902	420				1,328	840	488			
1984	1,372	943	429				1,315	844	471			
1983	1,300	918	382				1,229	800	429			
1982	760	540	220				711	452	259			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
APR	26	22	80	48	293	247	874	519	24	22	71	43	258	223	760	463
MAY	25	29	72	45	237	257	744	443	28	27	72	45	267	263	784	464
JUN	27	27	67	42	284	239	737	441	26	25	64	42	275	254	743	440
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	25	66	44	230	241	751	524	25	25	65	44	266	259	770	489
SEP$_P$	**24**	**23**	**60**	**38**	**224**	**229**	**693**	**437**	**26**	**24**	**65**	**51**	**251**	**227**	**754**	**564**
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
9 MONTHS																
1985	182	181	596	363					198	180	576	374				
1984	146	187	692	347					148	162	642	364				
1983	129	166	712	293					125	143	664	298				
1982	84	107	425	144					75	91	386	157				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in millions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
APR	283	60	354	6.7	$203,684	$84,000	$28,500	$91,184	1,088	643	445	127	91	36
MAY	297	65	355	6.4	201,472	83,676	28,360	89,436	1,089	644	445	132	85	47
JUN	297	65	355	6.1	198,405	82,926	29,233	86,246	1,075	634	441	164	108	56
JUL	311	62	354	5.9	199,236	83,572	29,475	86,189	1,073	636	437	146	100	46
AUG	337	59	354	6.0	201,903	84,245	29,547	88,111	1,086	643	443	153	103	50
SEPp	**380**	**54**	**356**	**6.6**	**207,816**	**84,130**	**31,327**	**92,359**	**1,066**	**626**	**440**	**156**	**109**	**47**
1983 TOTAL	2,719	623										1,390	1,016	374
1984 TOTAL	2,868	639										1,652	1,137	515
9 MONTHS														
1985	2,551	535										1,244	845	399
1984	2,250	505										1,210	835	375
1983	2,113	478										974	709	265
1982	1,503	301										715	506	209

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$20,183	$ 4,004	$ 7,922	$ 7,323	$ 93[illegible]	$ 13,591	$ 3,894	$ 5,722	$ 3,927	$ 48
FEB	20,961	4,273	7,941	7,351	1,396	12,944	3,717	5,618	3,555	54
MAR	25,406	4,333	10,681	8,350	2,042	16,517	4,037	7,887	4,502	91
APR	26,120	4,849	11,955	7,403	1,913	17,909	4,467	9,178	4,208	56
MAY	28,212	4,548	13,096	8,519	2,049	19,602	4,377	10,268	4,897	60
JUNp	**32,550**	**5,402**	**12,665**	**12,370**	**2,113**	**20,917**	**5,052**	**9,551**	**6,232**	**82**
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
6 MONTHS										
1985	153,435	27,409	64,260	51,319	10,447	101,481	25,544	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357
1982	55,367	11,480	18,504	21,528	3,855	36,305	9,000	15,079	11,998	228

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 1,228	$ 36	$ 691	$ 399	$ 102	$ 5,364	$ 74	$ 1,509	$ 2,997	$ 784
FEB	1,830	378	923	396	133	6,187	178	1,400	3,400	1,209
MAR	2,020	170	1,162	511	177	6,869	126	1,632	3,337	1,774
APR	1,937	163	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN$_P$	**2,329**	**228**	**1,417**	**590**	**94**	**9,304**	**122**	**1,697**	**5,548**	**1,937**
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
6 MONTHS										
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102
1982	3,159	740	1,232	958	229	15,903	1,740	2,193	8,572	3,398

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 17,115	$ 2,798	$ 9,207	$ 3,548	$ 1,562	$88,853	$8,463	$49,556	$16,711	$14,123
FEB	20,485	3,695	10,564	3,624	2,602	92,165	8,987	50,899	16,994	15,285
MAR	28,222	3,404	14,217	7,831	2,770	98,340	8,921	53,175	21,748	14,496
APR	24,853	3,897	14,893	3,798	2,265	97,905	10,616	55,146	15,865	16,278
MAY	25,999	4,355	15,100	4,115	2,429	98,643	10,108	55,898	16,223	16,414
JUN$_P$	**27,447**	**5,087**	**14,174**	**5,385**	**2,801**	**125,455**	**11,220**	**78,076**	**19,126**	**17,033**
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
6 MONTHS										
1985	144,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					
1982	48,974	17,670	18,789	9,290	3,225					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
APR	188	67	19	102	110	$ 7,103	35	$ 2,007	14	$ 944	61	$ 4,152
MAY	189	70	19	100	98	6,429	20	1,185	13	868	65	4,376
JUN	192	80	19	93	112	7,330	36	2,118	14	961	62	4,251
JUL	218	93	24	101	96	6,558	11	656	16	1,104	69	4,798
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP$_P$	**201**	**82**	**26**	**93**	**129**	**8,545**	**47**	**2,771**	**19**	**1,318**	**63**	**4,456**
1983 TOTAL	1,921	777	261	883	1,302	79,469	367	19,141	283	17,965	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,345	86,777	200	10,644	199	12,730	946	63,403
9 MONTHS												
1985	1,653	660	178	815	919	60,197	234	13,590	133	8,887	552	37,720
1984	1,419	318	154	947	1,072	69,184	169	9,006	161	10,352	742	49,826
1983	1,541	639	270	632	941	56,106	296	14,921	207	12,986	438	28,199
1982	650	240	95	315	388	21,266	72	3,254	70	4,024	246	13,988

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
APR	$ 1,921	$ 1,515	$40,952	$ 1,856	$ 4,672	$ 4,141	$ 2,201	$ 1,973	$ 2,230	$ 2,558
MAY	2,074	1,703	41,613	1,004	3,375	3,701	3,591	4,240	6,073	3,595
JUN	1,593	1,904	42,755	1,519	4,101	5,172	4,106	3,281	3,324	3,609
JUL	1,583	1,918	43,891	1,527	2,714	3,258	4,626	4,385	9,086	3,859
AUG	1,797	1,921	45,668	2,207	3,858	3,958	3,602	2,685	5,872	4,153
SEP	**1,638**	**1,739**	**48,769**	**3,654**	**2,757**	**2,919**	**4,219**	**4,501**	**6,927**	**4,403**
1983 TOTAL	18,606	17,558	—	13,081	30,921	32,846	22,952	21,376	70,461	50,495
1984 TOTAL	21,008	16,722	—	13,546	30,743	32,601	21,885	20,489	36,101	27,859
9 MONTHS										
1985	15,435	16,457	—	15,587	31,446	34,488	31,021	28,589	46,024	30,303
1984	14,461	12,376	—	9,903	20,359	21,606	12,642	11,590	27,527	21,882
1983	14,257	12,762	—	11,108	24,997	26,452	17,043	15,674	58,142	40,288
1982	14,831	9,490	—	7,529	23,062	22,962	15,838	15,987	32,783	10,675

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA Mandatory Delivery Yields ARM (5 yr. Treas.)	FNMA Mandatory Delivery Yields Conv.	APARTMENTS[5]
1985								
MAY	12.28%	12.49%	12.50%	12.06%	12.09%	12.038%	12.281%	13.34%
JUN	11.89	12.06	12.06	11.75	11.76	11.125	11.600	13.38
JUL	12.12	12.09	12.10	11.38	11.48	11.000	11.569	13.22
AUG	11.99	12.06	12.04	11.24	11.33	11.238	11.719	13.23
SEP	12.04	12.02	12.03	11.17	11.20	11.200	11.775	13.21
OCTp	**n.a.**	**n.a.**	**n.a.**	**11.02**	**11.30**	**10.675**	**11.588**	**13.03**

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
MAY	11.89%	—%	—%	12.25%	10.85%	7.65%	7.83%
JUN	11.20	11.20	11.23	11.62	10.16	7.09	7.35
JUL	11.26	11.30	11.27	11.64	10.31	7.20	7.56
AUG	11.39	11.38	11.42	11.77	10.33	7.32	7.72
SEP	11.41	11.43	11.47	11.87	10.37	7.27	7.83
OCT	**11.24**	**11.28**	**11.34**	**11.82**	**10.24**	**7.33**	**7.80**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
MAY	3	104	—	—
JUN	25	104	104	107
JUL	35	95	99	96
AUG	22	106	105	109
SEP	22	104	106	110
OCT	**n.a.**	**100**	**104**	**110**

n.a.—Not available. p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields

[5] Federal Home Loan Mortgage Corp. Existing Construction only

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year-to-date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
YEAR AND MONTH		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**	**4,880**	**3,860**	**70**	**770**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
YEAR AND MONTH	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH		1-4 Units				5+ Units			
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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MORTGAGE BANKING

JANUARY 1986

The Magazine
of Real Estate Finance

1986 ECONOMIC FORECAST

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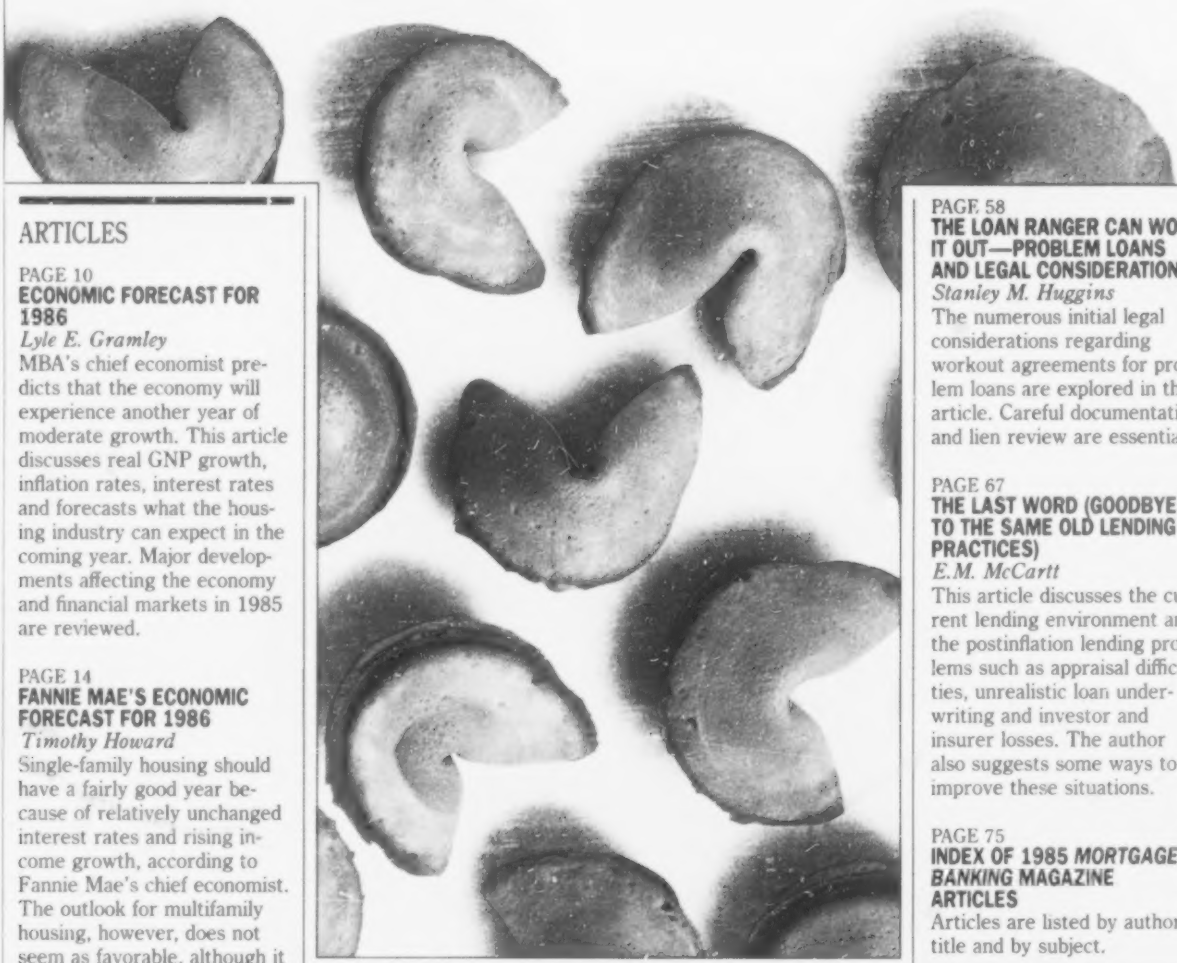

ARTICLES

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ECONOMIC FORECAST FOR 1986
Lyle E. Gramley
MBA's chief economist predicts that the economy will experience another year of moderate growth. This article discusses real GNP growth, inflation rates, interest rates and forecasts what the housing industry can expect in the coming year. Major developments affecting the economy and financial markets in 1985 are reviewed.

PAGE 14
FANNIE MAE'S ECONOMIC FORECAST FOR 1986
Timothy Howard
Single-family housing should have a fairly good year because of relatively unchanged interest rates and rising income growth, according to Fannie Mae's chief economist. The outlook for multifamily housing, however, does not seem as favorable, although it hinges heavily on whether or not the tax reform package becomes law.

PAGE 22
PREDICTING GNMA-TREASURY SPREADS: THE DETERMINING FACTORS
Marcelle Arak, Laurie Goodman and Judith Jonson
This article identifies the factors that are most important in determining the spreads between GNMAs and Treasuries. Keeping an eye on these variables will help in making the decision when to move into and out of mortgage-backed securities.

PAGE 34
OPTIMAL DELIVERY ANALYSIS: A RACE AGAINST TIME
Jonathan Prince
One area that has been overlooked by "automatons" is secondary marketing. But this author predicts that in the near future, secondary market professionals will be harvesting profits daily by utilizing computer technology to identify market opportunities that others will miss.

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WEATHERING THE EFFECTS PART II: TAX REFORM AND COMMERCIAL REAL ESTATE
Dr. Ronald E. Copley
This author believes that one of the greatest advantages of the proposed tax changes is relieving the harsh treatment of ACRS recapture rules at the time of sale through indexation of depreciation deductions. An examination of how commercial property would be affected by the President's tax proposal is outlined.

PAGE 58
THE LOAN RANGER CAN WORK IT OUT—PROBLEM LOANS AND LEGAL CONSIDERATIONS
Stanley M. Huggins
The numerous initial legal considerations regarding workout agreements for problem loans are explored in this article. Careful documentation and lien review are essential.

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THE LAST WORD (GOODBYE TO THE SAME OLD LENDING PRACTICES)
E.M. McCartt
This article discusses the current lending environment and the postinflation lending problems such as appraisal difficulties, unrealistic loan underwriting and investor and insurer losses. The author also suggests some ways to improve these situations.

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MORTGAGE MARKET TRENDS

The Mortgage Bankers Association's economic outlook (see article by Gramley, page 10) suggests that many of the favorable economic conditions in 1985, that allowed the housing industry to register its third consecutive year of strong sales and construction activity, are likely to continue in 1986. Economic growth is expected to remain moderate, employment will probably continue to register steady gains, the inflation rate should remain stable and mortgage rates are anticipated to average near the levels that prevailed in late 1985. As a result, we feel that 1986 should be another year of solid performance for housing.

However, it is also MBA's view that caution should be exercised in planning for the new year. While the forecasted financial environment augurs well for the housing industry, we do not expect housing activity in 1986 to improve materially for many of the reasons that restrained the industry's response to last year's sharp drop in interest rates.

In the first place, the strength of housing sales and construction during the last three years, combined with the sharp slowdown in households formed in the important 20- to 29-years of age group, means that backlogs of demand for housing built-up in the early 1980s may have been largely filled. Thus, significantly higher levels of housing activity will be harder to come by unless interest rates drop to unexpectedly low levels.

Moreover, although the level of nominal mortgage rates dropped substantially last year, the real level remained very high by historical standards. Barring a significant reduction in the federal budget deficit, there is little reason to believe that real interest rates will fall materially in 1986. As a consequence, the inflation-adjusted cost of homeownership is likely to remain high. In addition, the tighter underwriting standards that followed in the wake of rising mortgage loan delinquency rates will continue to make it more difficult for first-time homebuyers to qualify for loans.

Further, the marked slowdown in inflation in recent years has greatly diminished the speculative investment component of housing demand relative to the late 1970s and we do not expect much of a turnaround in this aspect of housing demand in 1986.

At the same time, while the economy as a whole is expected to continue growing next year, severely depressed economic conditions in the Midwest are likely to restrain housing activity in that region.

Finally, the construction of apartment buildings and commercial structures will be affected by the rise in vacancy rates and overbuilding that has occurred in many parts of the country. A reduction in multifamily construction may well occur and nonresidential construction will likely rise more slowly than in 1985.

On balance then, 1986 should shape up to be a year of opposing forces, leaving housing activity near the healthy levels experienced in 1985. Housing starts should hover around 1¾ million units, total home sales should be between 3.6 to 3.8 million units and single-family origination volume can be expected to rise only modestly from the estimated 1985 level of $210 billion. Given the favorable interest outlook, fixed-rate mortgages should account for about half of total originations, allowing the secondary mortgage market to remain at the healthy level of activity achieved in 1985.

Edison R. Zayas
Senior Economist
December 17, 1985

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
JUN	163	110	53	1,701	1,123	578	156	100	56	1,712	1,091	621
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	161	110	52	1,740	1,156	584	159	101	58	1,784	1,117	667
SEP	148	98	50	1,616	1,058	558	167	93	74	1,808	1,076	732
OCT	172	113	59	1,761	1,202	559	158	100	58	1,688	1,077	611
NOV$_P$	**120**	**77**	**43**	**1,547**	**1,021**	**526**	**119**	**73**	**46**	**1,648**	**1,021**	**627**
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
11 MONTHS												
1985	1,651	1,135	516				1,610	1,014	596			
1984	1,616	1,093	523				1,575	1,005	570			
1983	1,595	1,112	483				1,497	970	527			
1982	979	685	294				904	578	326			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
JUN	27	27	67	42	284	239	737	441	26	25	64	42	275	254	743	440
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	25	66	44	230	241	751	524	25	25	65	44	266	259	770	489
SEP	24	23	61	40	229	230	703	454	25	24	65	53	242	225	758	583
OCT	32	28	73	40	304	222	805	430	29	25	65	39	282	228	736	442
NOV$_P$	**19**	**15**	**56**	**30**	**209**	**186**	**730**	**422**	**21**	**16**	**51**	**31**	**279**	**199**	**709**	**461**
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
11 MONTHS																
1985	233	225	725	433					248	221	692	450				
1984	190	232	815	413					186	200	760	430				
1983	159	207	873	357					153	179	806	360				
1982	109	142	544	184					98	118	487	200				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in millions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
MAY	297	65	355	6.4	$201,472	$83,676	$28,360	$89,436	1,089	644	445	132	85	47
JUN	297	65	355	6.1	198,405	82,926	29,233	86,246	1,075	634	441	164	108	56
JUL	311	63	351	5.8	199,236	83,572	29,475	86,189	1,073	636	437	146	100	46
AUG	337	61	351	5.9	201,457	84,048	29,410	87,999	1,084	642	442	154	103	51
SEP	281	55	352	6.4	203,721	84,068	29,801	89,852	1,063	625	438	159	111	48
OCT$_P$	**296**	**54**	**357**	**6.5**	**205,350**	**85,690**	**30,920**	**88,740**	**1,090**	**637**	**453**	**150**	**108**	**42**
1983 TOTAL	2,719	623										1,390	1,016	374
1984 TOTAL	2,868	639										1,652	1,137	515
10 MONTHS														
1985	2,847	593										1,398	955	443
1984	2,484	559										1,369	939	430
1983	2,337	529										1,127	819	308
1982	1,676	341										817	577	240

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$20,183	$ 4,004	$ 7,922	$ 7,323	$ 934	$ 13,591	$ 3,894	$ 5,722	$ 3,927	$ 48
FEB	20,961	4,273	7,941	7,351	1,396	12,944	3,717	5,618	3,555	54
MAR	25,406	4,333	10,681	8,350	2,042	16,517	4,037	7,887	4,502	91
APR	26,120	4,849	11,955	7,403	1,913	17,909	4,467	9,178	4,208	56
MAY	28,212	4,548	13,096	8,519	2,049	19,602	4,377	10,268	4,897	60
JUN	**32,550**	**5,402**	**12,665**	**12,370**	**2,113**	**20,917**	**5,052**	**9,551**	**6,232**	**82**
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
6 MONTHS										
1985	153,435	27,409	64,260	51,319	10,447	101,481	25,544	48,224	27,322	391
1984	150,808	30,460	64,836	47,948	7,564	102,450	25,410	48,992	27,645	403
1983	126,145	33,860	44,644	41,714	5,927	89,407	28,390	35,322	25,338	357
1982	55,367	11,480	18,504	21,528	3,855	36,305	9,000	15,079	11,998	228

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 1,228	$ 36	$ 691	$ 399	$ 102	$ 5,364	$ 74	$ 1,509	$ 2,997	$ 784
FEB	1,830	378	923	396	133	6,187	178	1,400	3,400	1,209
MAR	2,020	170	1,162	511	177	6,869	126	1,632	3,337	1,774
APR	1,937	163	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN$_p$	**2,329**	**228**	**1,417**	**590**	**94**	**9,304**	**122**	**1,697**	**5,548**	**1,937**
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
6 MONTHS										
1985	11,337	1,009	6,654	2,808	866	40,617	856	9,382	21,189	9,190
1984	11,829	1,830	6,427	2,861	711	36,529	3,220	9,417	17,442	6,450
1983	9,643	2,990	3,710	2,475	468	27,095	2,480	5,612	13,901	5,102
1982	3,159	740	1,232	958	229	15,903	1,740	2,193	8,572	3,398

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JAN	$ 17,115	$ 2,798	$ 9,207	$ 3,548	$ 1,562	$88,853	$8,463	$49,556	$16,711	$14,123
FEB	20,485	3,695	10,564	3,624	2,602	92,165	8,987	50,899	16,994	15,285
MAR	28,222	3,404	14,217	7,831	2,770	98,340	8,921	53,175	21,748	14,496
APR	24,853	3,897	14,893	3,798	2,265	97,905	10,616	55,146	15,865	16,278
MAY	25,999	4,355	15,100	4,115	2,429	98,643	10,108	55,898	16,223	16,414
JUN$_p$	**27,447**	**5,087**	**14,174**	**5,385**	**2,801**	**125,455**	**11,220**	**78,076**	**19,126**	**17,033**
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
6 MONTHS										
1985	144,552	23,236	78,155	28,305	14,856					
1984	141,883	27,390	77,593	25,650	11,250					
1983	126,101	43,390	56,024	18,114	8,573					
1982	48,974	17,670	18,789	9,290	3,225					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
MAY	189	70	19	100	98	$ 6,429	20	$ 1,185	13	$ 868	65	$ 4,376
JUN	192	80	19	93	112	7,330	36	2,118	14	961	62	4,251
JUL	218	93	24	101	96	6,558	11	656	16	1,104	69	4,798
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP	201	82	26	93	130	8,545	47	2,771	20	1,318	63	4,456
OCT$_p$	**205**	**84**	**24**	**97**	**122**	**8,308**	**34**	**2,041**	**16**	**1,120**	**72**	**5,147**
1983 TOTAL	1,921	777	261	883	1,302	79,469	367	19,141	283	17,965	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,345	86,777	200	10,644	199	12,730	946	63,403
10 MONTHS												
1985	1,858	744	202	912	1,040	68,498	268	15,630	148	10,006	624	42,862
1984	1,592	378	169	1,045	1,175	75,859	181	9,620	172	11,022	822	55,217
1983	1,690	680	295	715	1,066	63,857	322	16,282	237	14,920	507	32,655
1982	765	292	111	362	434	23,897	81	3,679	76	4,411	277	15,807

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
MAY	$ 2,074	$ 1,703	$41,613	$ 1,004	$ 3,375	$ 3,701	$ 3,591	$ 4,240	$ 6,073	$ 3,595
JUN	1,593	1,904	42,755	1,519	4,101	5,172	4,106	3,281	3,324	3,609
JUL	1,583	1,918	43,891	1,527	2,714	3,258	4,626	4,385	9,086	3,859
AUG	1,797	1,921	45,668	2,207	3,858	3,958	3,602	2,685	5,872	4,153
SEP	1,638	1,739	48,769	3,654	2,757	2,919	4,219	4,501	6,927	4,403
OCT$_p$	**1,733**	**1,767**	**50,363**	**2,228**	**4,169**	**3,995**	**3,215**	**3,081**	**6,849**	**5,795**
1983 TOTAL	18,606	17,558	—	13,081	30,921	32,846	22,952	21,376	70,461	50,495
1984 TOTAL	21,008	16,722	—	13,546	30,743	32,601	21,885	20,489	36,101	27,859
10 MONTHS										
1985	17,168	18,224	—	15,587	35,615	38,483	34,236	31,671	52,873	36,098
1984	16,099	13,463	—	9,903	22,669	24,269	15,505	14,158	29,927	24,355
1983	16,139	14,006	—	11,108	28,064	29,050	19,929	19,117	62,033	44,096
1982	16,256	10,940	—	7,529	25,480	25,418	17,838	18,188	34,081	12,116

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA Mandatory Delivery Yields ARM (5 yr. Treas.)	FNMA Mandatory Delivery Yields Conv.	APARTMENTS[5]
1985								
JUN	11.89%	12.06%	12.06%	11.75%	11.76%	11.125%	11.600%	13.38%
JUL	12.12	12.09	12.10	11.38	11.48	11.000	11.569	13.22
AUG	11.99	12.06	12.04	11.24	11.33	11.238	11.719	13.23
SEP	12.04	12.02	12.03	11.17	11.20	11.200	11.775	13.21
OCT	11.87	11.86	11.88	11.09	11.32	n.a.	11.575	13.03
NOV$_p$	n.a.	n.a.	n.a.	**11.02**	**11.29**	n.a.	**11.138**	**12.38**

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
JUN	11.20%	11.20%	11.23%	11.62%	10.16%	7.09%	7.35%
JUL	11.26	11.30	11.27	11.64	10.31	7.20	7.56
AUG	11.39	11.38	11.42	11.77	10.33	7.32	7.72
SEP	11.41	11.43	11.47	11.87	10.37	7.27	7.83
OCT	11.24	11.28	11.34	11.82	10.24	7.33	7.80
NOV	**10.96**	**10.95**	**11.01**	**11.38**	**9.78**	**7.30**	**7.77**

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
JUN	25	104	104	107
JUL	35	95	99	96
AUG	22	106	105	109
SEP	17	104	106	110
OCT	49	100	104	110
NOV	n.a.	**118**	**117**	**123**

n.a.—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**	**4,880**	**3,860**	**70**	**770**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

		1-4 Units				5+ Units			
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4] 1-4 Units	COVERAGE[4] 5+ Units	COVERAGE[4] Non-[3] res.	SERVICING VOLUME[1] Total	SERVICING VOLUME[1] 1-4 Units	SERVICING VOLUME[1] 5+ Units	SERVICING VOLUME[1] Non.[3] res.	NOTES PAYABLE[1] (End of Month Balances) Total	NOTES PAYABLE[1] Comm. Paper	NOTES PAYABLE[1] To Banks	NOTES PAYABLE[1] To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	**56**	**96**	**88**	**385,270**	**321,620**	**33,110**	**30,540**	**42,280**	**8,390**	**23,680**	**10,210**

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED Total	CONSTRUCTION LOANS CLOSED 1-4 Units	CONSTRUCTION LOANS CLOSED 5+ Units	CONSTRUCTION LOANS CLOSED Non-[3] res.	DISBURSEMENTS DURING MONTH Total	DISBURSEMENTS DURING MONTH 1-4 Units	DISBURSEMENTS DURING MONTH 5+ Units	DISBURSEMENTS DURING MONTH Non-[3] res.	Land Loans	END OF MONTH INVENTORY Total	END OF MONTH INVENTORY 1-4 Units	END OF MONTH INVENTORY 5+ Units	END OF MONTH INVENTORY Non-[3] res.	END OF MONTH INVENTORY Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	**470**	**270**	**120**	**80**	**430**	**220**	**30**	**180**	**470**	**9,240**	**3,790**	**790**	**4,660**	**3,440**

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH Total	ISSUED DURING MONTH 1-4 Units	ISSUED DURING MONTH 5+ Units	ISSUED DURING MONTH Non-[3] res.	END OF MONTH BALANCES Total	END OF MONTH BALANCES 1-4 Units	END OF MONTH BALANCES 5+ Units	END OF MONTH BALANCES Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	**790**	**200**	**10**	**580**	**3,910**	**930**	**280**	**2,700**

Notes [1] All dollar amounts are in millions

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated

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MORTGAGE BANKING

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Multifamily Securities

An Untapped Market

Last summer, the Federal Home Loan Mortgage Corporation (Freddie Mac) extended the horizons of the secondary mortgage market when the first pass-through securities, backed entirely by newly originated multifamily mortgages, were sold. After selling $700 million worth of multifamily participation certificates (PCs) in August 1985, Freddie Mac introduced them to foreign investors with a $100 million sale in September. The creation of the multifamily PC represents a crucial step in improving the liquidity of multifamily loans and should increase the flow of funds to that sector.

In designing the multifamily PC, Freddie Mac adapted the structure of the single-family PC to correspond with both the features of the underlying multifamily mortgages and the preferences of targeted institutional investors. The structure of the new multifamily PCs is that of a straight pass-through using the grantor trust vehicle. Freddie Mac purchases mortgages of a specific type (which is called a Plan B mortgage), pools the mortgages and sells securities representing undivided interests in the mortgage pool. Freddie Mac collects monthly principal and interest payments from seller/servicers, then passes through a *pro rata* share to each PC holder, guaranteeing investors timely payment of interest at the PC coupon rate and ultimate return of principal.

Compared with the original single-family PCs that are backed by 30-year fixed-rate mortgages, the multifamily PCs have shorter expected lives, reflecting the 10-year to 15-year terms of the underlying Plan B mortgages. Plan B mortgages are first lien, fixed-rate, conventional mortgages on properties of five or more units. Typically, they are amortized over 30 years with a balloon payment at maturity. Subject to Freddie Mac's approval, a Plan B mortgage may be assumed at any time by a creditworthy borrower at the original note rate.

A key feature of the multifamily PC that appeals to institutional investors is the explicit call protection it provides during the early years. This is the first mortgage-related security to provide the investor with call protection as well as an intermediate life. Because Plan B mortgages have lock-out periods during which prepayment is prohibited, PC holders are fully protected from prepayments for that period. The mortgages backing the initial $700 million PC sale have lock-out periods ranging from 33 to 64 months from the PC issue date and those backing the $100 million foreign sale have lock-out periods ranging from 51 to 59 months. After the expiration of the lock-out period, prepayments are permitted, subject to a fee of at least 1 percent of the amount of principal prepaid.

"By developing a security backed entirely by multifamily mortgages, Freddie Mac has broken down some real and perceived barriers to securitizing multifamily mortgages."

By developing a security backed entirely by multifamily mortgages, Freddie Mac has broken down some real and perceived barriers to securitizing multifamily mortgages. Some analysts have argued that the diversity of loan types, relatively complex underwriting and greater perceived risks of multifamily mortgages would prevent the securitization of these loans. (See the article in *Secondary Mortgage Markets*, Winter 1985-86 for a more complete discussion.) Freddie Mac's success stems from experience in developing single-family mortgage-backed securities, technological and human resources and Freddie Mac's financial strength.

Freddie Mac selected a specific type of loan on which to focus the securitization efforts: the popular fixed-rate balloon loan. Once lenders and investors fully accept this program, Freddie Mac and other mortgage conduits can expand the formal secondary market to include additional loan types. Freddie Mac's financial strength and status as a congressionally chartered corporation have helped to allay investors' concerns about the risks of multifamily mortgage investments. Increased familiarity with these investments should gradually reduce the risk premiums in-

Leland Brendsel

ILLUSTRATION BY [illegible]

vestors require, making it more feasible for private firms to issue multifamily securities. Selling loans should become faster and easier as the rapid pace of technological developments causes underwriting and other mortgage processing tasks to become increasingly automated and, therefore, less time-consuming.

How to sell loans to Freddie Mac

Selling multifamily mortgages or participation interests to Freddie Mac is easy. Originators can sell either loans already closed and on their books or new originations.

The first step is to determine whether the particular loan or loans meet the basic criteria for Freddie Mac's eligible mortgage types, Plan A and Plan B (see box listing criteria). Plan A loans generally are fixed-rate, fully amortizing, nonassumable loans with original terms of 10 years to 30 years. The more popular Plan B loans usually are 10-year to 15-year loans amortized over a period of up to 30 years with a balloon payment at maturity. Although any creditworthy borrower may assume a Plan B loan with Freddie Mac's approval, prepayment is prohibited for at least 54 months following delivery to Freddie Mac.

Once originators have determined that their loans meet either the Plan A or the Plan B basic requirements, the key question is price. To find out the current required net yield, call the Freddie Mac commitment rate line at (202) 789-4500 or check Telerate page 7119. If rates seem attractive, obtain a purchase commitment by calling (202) 789-2200 between 11:00 a.m. and 2:00 p.m. (Eastern Standard Time) on any business day.

Leland Brendsel is acting president of Freddie Mac. Prior to September 1985, Brendsel was executive vice president and chief financial officer. He directed the corporate finance, treasury, financial planning, securities trading and control functions. He was directly responsible for introducing the collaterized mortgage obligation in 1983. Prior to joining Freddie Mac, Brendsel was vice president and chief economist at the Federal Home Loan Bank Board at Des Moines, Iowa.

Freddie Mac offers two delivery programs which are available for both Plan A and Plan B mortgages. The immediate delivery program is designed for loans that are already closed and on the lender's books. Once the lender obtains a purchase commitment from Freddie Mac, the lender must deliver the loan within 30 days. Lenders can sell loans that are still in process through an immediate delivery commitment, but because delivery is mandatory, the seller must be certain that it can close and deliver the loan within 30 days. Substitution of loans is generally not permitted, unless Freddie Mac requires the lender to do so. When the lender obtains Freddie Mac's immediate delivery purchase commitment, he locks in the required net yield for the 30-day period. The seller pays a loan review fee of $1,500 or 1 percent of the purchase contract amount (whichever is greater) when it submits the purchase contract and loan to Freddie Mac (within 24 hours of receiving the executed contract).

> "Freddie Mac's prior approval program enables the lender to obtain a firm purchase commitment before closing a loan."

ELIGIBLE MORTGAGES

	Plan A	Plan B
Minimum loan amount*	$100,000	$100,000
Maximum loan amount*	$7.5 million	$20 million
Minimum remaining term	10 Years	10 Years
Original term to maturity	10-30 Years	10-15 Years
Amortization period	10-30 Years	10-30 Years
Assumable**	No	Yes
Prepayment	Any time	Prohibited for at least 54 months after our purchase

*Original mortgage amount

Freddie Mac's prior approval program enables the lender to obtain a firm purchase commitment before closing a loan. Freddie Mac reviews the loan and underwriting and, if the loan is acceptable, quotes a yield and commits to purchase the loan at that yield. The lender then has 10 business days to accept Freddie Mac's offer and pay a 2 percent commitment fee; Freddie Mac refunds 1.5 percent when the seller delivers the required documentation. Upon acceptance of Freddie Mac's offer, the seller has 90 days to close and deliver the loan. The seller must convert to a 30-day mandatory delivery contract within 60 days of the expiration of the 10-business day offer period. The seller, of course, can choose not to deliver the loan, forfeiting the commitment fee.

Although the seller locks in a maximum required net yield for the length of the commitment period, at any time during that 60-day period the seller can convert to a mandatory delivery contract at the current immediate delivery rate rather than the maximum yield quoted earlier. Thus, the seller can take advantage of any decline in rates during the commitment period but also is protected from rising rates by the maximum required net yield at the time of commitment.

What about servicing? Freddie Mac requires the seller to continue servicing the mortgage sold and, for whole loans, to retain a minimum spread over Freddie Mac's required net yield as compensation. The minimum servicing spread varies with the original loan amount. For loan amounts of $1 million or less, the minimum spread is 25 basis points. For loan amounts higher than $1 million and less than $10 million, Freddie Mac will negotiate the required spread on a case-by-case basis. If the lender is retaining a participation interest in the mortgage, its servicing compensation is the portion of the mortgage interest income exceeding Freddie Mac's required net yield.

Regarding underwriting and documentation, Freddie Mac's policies reflect the basic goal of purchasing investment quality mortgages. Obviously, Freddie Mac is concerned with both the creditworthiness of the borrower and the profitability of the un-

continued

derlying property. Not surprisingly, Freddie Mac requires the borrower's financial statements, the current rent schedule and the property's income and expense statements covering the current year and the two preceding years (or *pro forma* statements for new or rehabilitated properties). Freddie Mac also requires submission of all appraisal reports obtained within the previous 30 months and a current appraisal (within 90 days of loan closing). Freddie Mac's *Seller/Servicers Guide* provides all of the details regarding underwriting guidelines and documentation requirements.

The best sources of information regarding Freddie Mac's multifamily purchase programs are the multifamily specialists in the Freddie Mac regional office serving each state and the Freddie Mac's *Seller/Servicers Guide*.

Other efforts to securitize multifamily mortgages

Freddie Mac's new multifamily PC is the first pass-through security backed by newly originated multifamily loans, but it is not the only game in town. Both Freddie Mac and Fannie Mae offer swap programs for multifamily mortgages which improve the liquidity of multifamily mortgages in lenders' portfolios. Lenders can exchange a group of mortgages for PCs or Fannie Mae mortgage-backed securities (MBSs) representing interests in that group of mortgages. Freddie Mac negotiates these multifamily swap transactions individually through Freddie Mac's special deals department headquartered in the Washington, D.C. office. Freddie Mac has exchanged PCs for approximately $828 million worth of multifamily mortgages from the first swap in June 1984 through December 1, 1985. In one of these transactions, Freddie Mac swapped PCs for a pool of variable interest rate (VIR) mortgages, precursors of today's adjustable rate mortgages, (ARMs) which were commonly used by California chartered banks prior to deregulation.

The Government National Mortgage Association (Ginnie Mae) offers a pass-through security program for FHA-insured mortgages secured by multifamily properties. An institution originates or purchases a mortgage and sells securities backed by that individual mortgage which must be at least $500,000. Ginnie Mae guarantees the security holders timely payment of principal and interest. In addition to fixed-rate, level-payment loans, mortgages with monthly payments that change according to a predetermined schedule, such as GPMs and balloon loans are eligible; the schedule of security payments corresponds to the schedule of mortgage payments. In the first three quarters of 1985, issuance of Ginnie Mae multifamily pass-throughs totaled $525 million, bringing the volume outstanding to $5.2 billion.

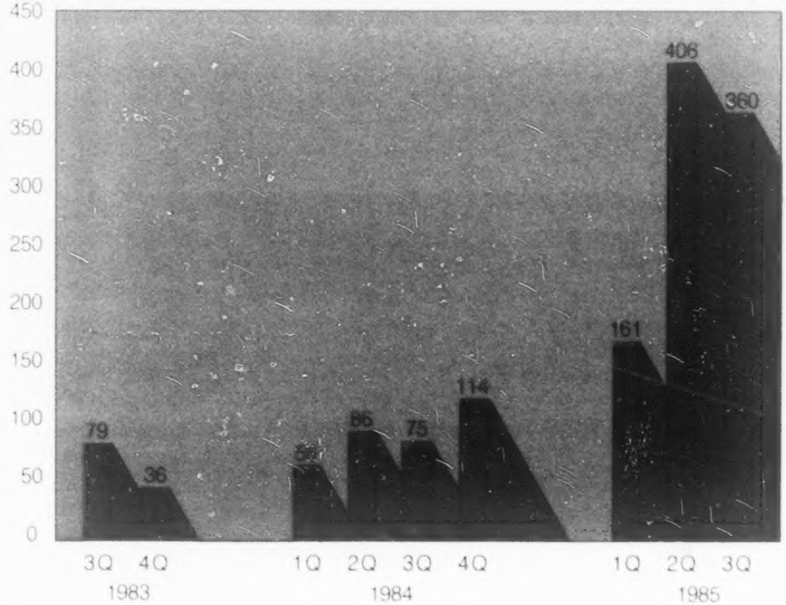
The Federal National Mortgage Association (Fannie Mae) purchases conventional multifamily mortgages for its portfolio, in addition to swapping mortgage pass-through securities for pools of multifamily loans. Eligible loans have fixed rates and maturities of 7 years, 10 years or 15 years with payments based on an amortization rate of up to 30 years and a balloon payment at maturity. Prepayments are prohibited for the first five years. Fannie Mae purchased $506 million worth of multifamily mortgages in the first three quarters of 1985 which brought its holdings to $6.2 billion or 6 percent of its portfolio. At the time of this writing, Fannie Mae had not sold for cash any securities specifically backed by the multifamilies it has purchased.

Looking ahead

Having successfully marketed the initial offerings of multifamily PCs, Freddie Mac plans to issue multifamily PCs regularly. Freddie Mac purchases multifamily Plan B mortgages daily at yields announced on the commitment line and expects to bring PCs to market as Freddie Mac accumulates adequate mortgage inventory. After purchasing $331 million worth of multifamily mortgages in 1984, Freddie Mac purchased $927 million in the first three quarters of 1985. (See graph of Freddie Mac multifamily purchases.) Freddie Mac expects purchase volume to continue rising, given the attractive required net yields, as more originators discover the ease and profitability of selling multifamily loans to Freddie Mac. The volume of new originations of multifamily mortgages, projected to be $25 billion in 1985, implies tremendous growth potential. Moreover, the $179 billion of outstanding multifamily loans represents a largely untapped market for mortgage conduits. □

GRAPH 1

**Freddie Mac Purchases of Multifamily Mortgages (Excluding Swaps)
($ in Millions)**



MORTGAGE MARKET TRENDS

Economic expansion continued at a moderate pace in the fourth quarter of 1985. The Commerce Department's "flash" estimate of 3.2 percent GNP growth for the fourth quarter was up only slightly from their revised estimate of 3 percent in the third. The previous estimate for third quarter growth was 4.3 percent. Inclusion of the fourth quarter estimate results in a 1985 GNP growth rate of 2.4 percent, down sharply from the 6.6 percent experienced in 1984.

In the third quarter, growth of final sales was stimulated by a surge of new car buying propelled by auto manufacturers' financing incentives; auto inventories declined. In the fourth quarter, the rise of final sales slowed appreciably, while business inventory investment turned up again as a result of increased stocks of domestic cars.

The closing months of 1985 have produced statistics of a somewhat divergent nature. The civilian unemployment rate registered three consecutive monthly declines, to 6.8 percent in December. During this time, payroll employment increased by over 800,000 jobs. Just as importantly, employment within manufacturing reversed its third quarter decline, accounting for about 10 percent of the quarterly gain in total employment. Additionally, hours worked in manufacturing during December rose to its highest level in more than a year.

Data on the industrial sector through November do not as yet show any pick up in output. Although industrial production in November rose 0.4 percent, the increase merely offset the October decline. The November gain primarily reflected a gain in durable goods production—defense equipment, autos and consumer home goods. New orders for durable goods continued to slide in November but an increase in nondurable orders pushed total orders up 1 percent.

Factory shipments rose again in November, the third increase in four months. Manufacturers' inventories fell again in November, continuing the downtrend in evidence since March, a downtrend that has resulted in a significant decline in the manufacturers' inventory/shipments ratio.

Following October's decline in retail sales, November sales volume rose a moderate 0.7 percent but showed further strength in December, rising 1.9 percent. The reintroduction of auto financing incentives in December led to a strengthening of auto sales and upticks in food and energy prices helped boost sales at food stores and gasoline stations in both November and December. Total fourth quarter sales remained below the third quarter level, however, when auto sales were extremely strong.

Excluding December auto buying, durable goods sales registered a healthy 4.3 percent increase during the month, up from a 0.7 percent rise in November. Nondurable goods sales increased 0.6 percent in both November and December.

Reflecting recent declines in mortgage interest rates, new home sales picked up in November from their lethargic pace in late summer and early fall. Housing starts slipped to 1.5 million units, however, reversing the October increase. The November decline may be weather related. In any event, housing starts in October and November together averaged about 1.65 million units, still close to the third quarter average. Given recent declines in mortgage rates, it is not unreasonable to expect increased activity in home construction in the near future.

The outlook for prices continues to be optimistic. Although consumer prices rose 0.6 percent in November, more than in earlier months, the jump was caused by temporary increases in food and energy costs. When food and energy are excluded, consumer prices in November compare favorably with earlier monthly increases. At the wholesale level, producer prices of finished goods increased sharply in October and November, but rose more modestly in December. In large part, the cause of the October-November bulge was a temporary rise in food and energy prices. In all of 1985, crude material prices actually fell 5½ percent, intermediate goods prices dropped 0.3 percent and prices for finished goods rose by less than 2 percent. Although the decline in the exchange value of the dollar is already having an effect on prices of some imported goods, the basic rate of inflation is unlikely to change significantly in 1986.

Two fourth quarter developments suggest that economic growth in the first half of 1986 may be slightly better than we had earlier anticipated. First, the fourth quarter bond market rally reduced long-term market increase rates by about 1¼ percentage points and was accompanied by substantial increases in equity values. Some of the gains in these two markets have recently been reversed, but these increases in the value of financial assets should have positive effects on spending and output in 1986. Second, increased strength in the industrial sector is suggested by the turnaround in manufacturing employment in the fourth quarter. This turnaround may reflect the fact that domestic producers are able to compete more effectively in international markets, given current levels of the exchange rate.

We believe that GNP growth in the first half of 1986 may stay close to the 3 percent plus pace of the last half of 1985, with somewhat better increases in net exports, consumer spending and housing activity than we expected earlier. New home sales may, for a short time, move up to above the 700 thousand level, with housing starts touching 1.8 million units. With this better outlook for economic growth, interest rates are unlikely to fall further. A significant upturn in interest rates as a result of this strengthening economy, however, is also unlikely. Longer-term interest rates, nonetheless, may be influenced by Federal budget developments, particularly with market perceptions of whether or not the Gramm-Rudman law will be effective in reducing the deficit.

Gregory D. Luetscher
Economist
January 14, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
JUN	163	110	53	1,701	1,123	578	156	100	56	1,712	1,091	621
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	161	110	52	1,740	1,156	584	159	101	58	1,784	1,117	667
SEP	148	98	50	1,616	1,058	558	167	93	74	1,808	1,076	732
OCT	172	113	59	1,761	1,202	559	158	100	58	1,688	1,077	611
NOV$_P$	120	77	43	1,547	1,021	526	119	73	46	1,648	1,021	627
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
11 MONTHS												
1985	1,651	1,135	516				1,610	1,014	596			
1984	1,616	1,093	523				1,575	1,005	570			
1983	1,595	1,112	483				1,497	970	527			
1982	979	685	294				904	578	326			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
YEAR AND MONTH	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
JUN	27	27	67	42	284	239	737	441	26	25	64	42	275	254	743	440
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	25	66	44	230	241	751	524	25	25	65	44	266	259	770	489
SEP	24	23	61	40	229	230	703	454	25	24	65	53	242	225	758	583
OCT	32	28	73	40	304	222	805	430	29	25	65	39	282	228	736	442
NOV$_P$	19	15	56	30	209	186	730	422	21	16	51	31	279	199	709	461
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
11 MONTHS																
1985	233	225	725	433					248	221	692	450				
1984	190	232	815	413					186	200	760	430				
1983	159	207	873	357					153	179	806	360				
1982	109	142	544	184					98	118	487	200				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in millions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
JUN	297	65	354	6.1	$198,405	$82,926	$29,233	$86,246	1,075	634	441	164	108	56
JUL	311	63	351	5.8	198,747	83,354	29,475	85,918	1,073	636	437	146	100	46
AUG	337	61	351	6.0	201,344	83,976	29,383	87,985	1,084	642	442	154	103	51
SEP	281	54	352	6.5	203,375	84,096	29,716	89,563	1,063	624	439	158	110	48
OCT	301	52	360	6.8	204,382	85,325	30,559	88,498	1,090	635	455	151	110	41
NOV$_P$	247	46	360	6.6	205,728	85,235	30,695	89,798	1,085	629	456	138	98	40
1983 TOTAL	2,719	623										1,390	1,016	374
1984 TOTAL	2,868	639										1,652	1,137	515
11 MONTHS														
1985	3,099	639										1,536	1,054	482
1984	2,694	601										1,503	1,034	469
1983	2,539	574										1,252	913	339
1982	1,843	380										911	645	266

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg Bankers[3]	S&Ls	Banks[2]	Life Cos	Total	Mtg. Bankers[3]	S&Ls	Banks[2]	Life Cos
1985										
FEB	$20,961	$4,273	$ 7,941	$ 7,351	$1,396	$12,944	$3,717	$5,618	$3,555	$ 54
MAR	25,406	4,333	10,681	8,350	2,042	16,517	4,037	7,887	4,502	91
APR	26,120	4,849	11,955	7,403	1,913	17,909	4,467	9,178	4,208	56
MAY	28,212	4,548	13,096	8,519	2,049	19,602	4,377	10,268	4,897	60
JUN	32,571	5,423	12,665	12,370	2,113	20,945	5,080	9,551	6,232	82
JUL$_P$	30,932	6,028	11,709	11,051	2,144	20,959	5,655	9,093	6,110	101
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
7 MONTHS										
1985	184,388	33,458	75,969	62,370	12,591	122,467	31,227	57,317	33,431	492
1984	175,871	33,330	77,815	55,992	8,734	123,189	31,187	59,205	32,322	475
1983	149,110	37,568	54,919	49,701	6,922	110,261	35,547	43,619	30,674	421
1982	67,238	14,857	21,931	25,749	4,701	45,997	13,406	18,001	14,302	288

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

	5+ UNITS					NONRESIDENTIAL				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
FEB	$1,830	$378	$ 923	$396	$133	$6,187	$178	$1,400	$3,400	$1,209
MAR	2,020	170	1,162	511	177	6,869	126	1,632	3,337	1,774
APR	1,937	163	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN	2,329	228	1,417	590	94	9,297	115	1,697	5,548	1,937
JULp	**1,770**	**19**	**974**	**604**	**173**	**8,203**	**354**	**1,642**	**4,337**	**1,870**
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
7 MONTHS										
1985	13,108	1,028	7,628	3,413	1,039	48,813	1,203	11,024	25,526	11,060
1984	12,039	348	7,390	3,514	787	40,643	1,795	11,220	20,156	7,472
1983	8,225	425	4,469	2,792	539	30,624	1,596	6,831	16,235	5,962
1982	3,413	550	1,438	1,148	277	17,828	901	2,492	10,299	4,136

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

	ISSUED DURING MONTH					OUTSTANDING				
YEAR AND MONTH	Total	Mtg Bankers[7]	S&Ls	Banks[2]	Life Cos	Total	Mtg Bankers[9]	S&Ls	Banks[2]	Life Cos
1985										
FEB	$20,485	$3,695	$10,564	$3,624	$2,602	$ 92,165	$ 8,987	$50,899	$16,994	$15,285
MAR	28,222	3,404	14,217	7,831	2,770	98,340	8,921	53,175	21,748	14,496
APR	24,853	3,897	14,893	3,798	2,265	97,905	10,616	55,146	15,865	16,278
MAY	25,999	4,355	15,100	4,115	2,429	98,643	10,108	55,898	16,223	16,414
JUN	27,516	5,156	14,174	5,385	2,801	103,639	11,401	56,079	19,126	17,033
JULp	**26,393**	**4,288**	**14,594**	**4,928**	**2,583**	**95,189**	**10,167**	**49,838**	**17,882**	**17,302**
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
7 MONTHS										
1985	171,014	27,593	92,749	33,233	17,439					
1984	162,382	29,098	91,017	29,886	12,381					
1983	146,079	43,645	70,116	21,581	10,737					
1982	56,091	19,011	22,326	10,984	3,770					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
YEAR AND MONTH	Total	FHA[1]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt	Units	Amt	Units	Amt	Units	Amt
1985												
JUN	192	80	19	93	112	$7,330	36	$2,118	14	$ 961	62	$4,251
JUL	218	93	24	101	96	6,558	11	656	16	1,104	69	4,798
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP	201	82	26	93	130	8,545	47	2,771	20	1,318	63	4,456
OCT	205	84	24	97	122	8,308	34	2,041	16	1,120	72	5,147
NOVp	**173**	**78**	**27**	**68**	**128**	**8,488**	**47**	**2,795**	**25**	**1,693**	**56**	**4,000**
1983 TOTAL	1,921	777	261	883	1,302	79,469	367	19,141	283	17,965	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,345	86,777	200	10,644	199	12,730	946	63,403
11 MONTHS												
1985	2,031	822	229	980	1,168	76,986	315	18,425	173	11,699	680	46,862
1984	1,736	427	182	1,127	1,262	82,462	190	10,260	185	12,730	887	59,472
1983	1,830	721	314	795	1,198	71,876	356	18,093	263	16,518	579	37,265
1982	907	375	134	398	482	26,632	91	4,177	84	4,866	307	17,589

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm	Purc	Outstanding	Issued	Comm to Sell	Comm to Buy	Mtg Purc	Mtg Sold	Applications	Issued
1985										
JUN	$ 1,593	$ 1,904	$42,755	$ 1,519	$ 4,101	$ 5,172	$ 4,106	$ 3,281	$ 3,324	3,609
JUL	1,583	1,918	43,891	1,527	2,714	3,258	4,626	4,385	9,086	3,859
AUG	1,797	1,921	45,668	2,207	3,858	3,958	3,602	2,685	5,872	4,153
SEP	1,638	1,739	48,769	3,654	2,757	2,919	4,219	4,501	6,927	4,403
OCT	1,733	1,767	50,363	2,228	4,169	3,995	3,215	3,081	6,849	5,795
NOVp	1,199	1,624	52,198	2,469	n.a.	n.a.	n.a.	n.a.	6,059	5,251
1983 TOTAL	18,606	17,558	—	13,081	30,921	32,846	22,952	21,376	70,461	50,495
1984 TOTAL	21,008	16,722	—	13,546	30,743	32,601	21,885	20,489	36,101	27,859
11 MONTHS										
1985	18,367	19,848	—	20,284	35,615*	38,483*	34,236*	31,671*	58,932	41,349
1984	18,249	14,759	—	12,254	22,669	24,269	15,505	14,158	32,849	25,787
1983	17,136	15,354	—	12,500	28,064	29,050	19,929	19,117	66,234	47,953
1982	19,053	12,621	—	9,367	25,480	25,418	17,838	18,188	35,773	13,680

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA Mandatory Delivery Yields		
	FHA	CONVENTIONAL		CONVENTIONAL				
	NEW[4]	New	Existing	New	Existing	ARM (5 yr. Treas.)	Conv	
1985								
JUL	12.12%	12.09%	12.10%	11.38%	11.48%	11.000%	11.569%	13.22%
AUG	11.99	12.06	12.04	11.24	11.33	11.238	11.719	13.23
SEP	12.04	12.02	12.03	11.17	11.20	11.200	11.775	13.21
OCT	11.87	11.86	11.88	11.09	11.32	n.a.	11.575	13.03
NOV	11.28	11.56	11.58	11.01	11.26	n.a.	11.160	12.38
DECp	n.a.	n.a.	n.a.	10.67	11.14	n.a.	10.425	12.06

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
				A-Rated[7]	U.S. Government		Prime Comm. Paper
	GNMA[6]	FNMA[6]	FHLMC[6]	Utility	10-yr	26-wk	90-119 Days
1985							
JUL	11.26%	11.30%	11.27%	11.64%	10.31%	7.20%	7.56%
AUG	11.39	11.38	11.42	11.77	10.33	7.32	7.72
SEP	11.41	11.43	11.47	11.87	10.37	7.27	7.83
OCT	11.24	11.28	11.34	11.82	10.24	7.33	7.80
NOV	10.96	10.95	11.01	11.38	9.78	7.30	7.77
DEC	n.a.	n.a.	n.a.	10.91	9.26	7.14	7.75

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
JUN	25	104	104	107
JUL	35	95	99	96
AUG	22	106	105	109
SEP	17	104	106	110
OCT	49	100	104	110
NOV	(10)	118	117	123

n.a.—Not available; p—Preliminary

[1] From the National Association of Realtors' Existing Home Sales Series

[2] Mutual Savings Banks and Commercial Banks

[3] FHA applications received includes the Direct Endorsement Program starting in 1984

[4] Secondary market gross yields

[5] Federal Home Loan Mortgage Corp. Existing Construction only

[6] Securities for 0 to 30 day delivery

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds

[8] Year to date seasonally adjusted series not calculated

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity

* 10 Month Totals

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$3,760	$3,330	$800	$530	$2,000	$0	$0	$0	$430	$3,530	$2,960	$0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,880	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[2]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	30,470	22,820	6,390	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$4,060	$2,940	$0	$1,120	$4,050	$3,580	$20	$450	$10,840	$70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	260	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	6,570						
12 MONTHS[2]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH	Total	1-4 Units				5+ Units			Non-res.[3]
		Total	FHA	VA	Conv.	Total	FHA	Conv.	
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	580

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Total	Comm Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res	Total	1-4 Units	5+ Units	Non-[3] res
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year to date seasonally adjusted series not calculated.

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MORTGAGE BANKING

MARCH 1986

$219 SU
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4520 EAST-WEST HGWY, SITE 200
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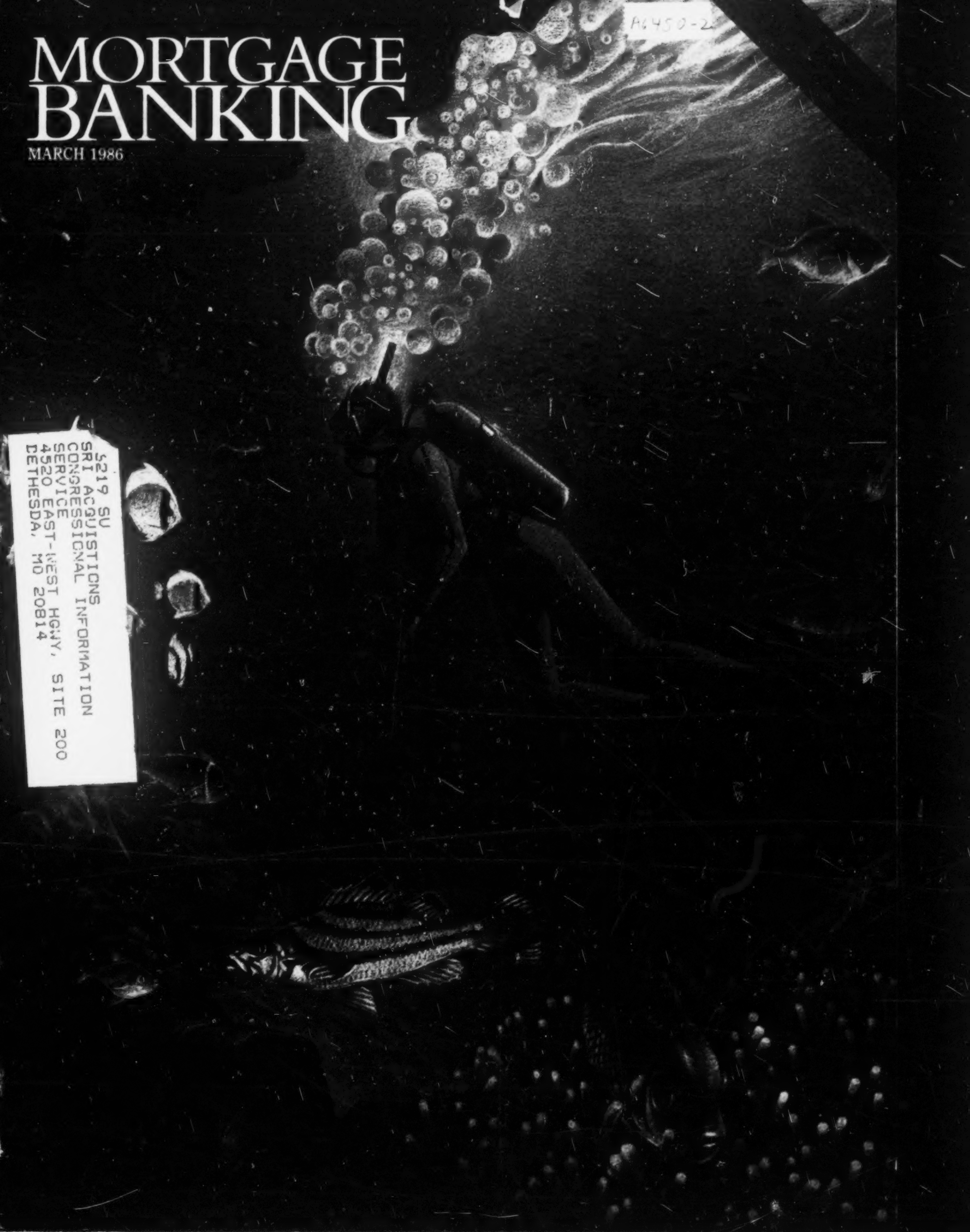

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ARMs: STILL A BOUNTIFUL CATCH

Thomas S. LaMalta and Jon G. Holm

Adjustable rate mortgages are no longer unknown or questionable commodities in the eyes of the borrower. This article encourages mortgage bankers to remain interested in ARMs because there is both an investor market and consumer interest in them. MGIC's experience with ARMs provides sellers with substantive information about what features investors are looking for.

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WHAT'S NEW AT THE BOARD OF TRADE?

Thomas Thompson

Cash settled GNMA futures will begin trading at the CBOT this May. This futures contract sidesteps all the issues and complications associated with deliveries of GNMAs certificates or CDRs. According to the author of this article, all the usual worries about timing, invoicing and ascertaining what security is cheapest to deliver do not arise.

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STRATEGIC PIPELINE HEDGING: COST EFFECTIVE APPROACH

Stephen R. Rigsbee and Sirri Ayaydin

This article explains how mortgage lenders can hedge mortgage pipeline risk using Treasury bond futures and futures options. The efficient and liquid markets for these instruments should motivate mortgage lenders to use them in their pipeline hedging programs.

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CMOs: GUARANTEED DELIVERY

Les Parker

All the factors involved in establishing and running a CMO program are detailed in this article. CMOs deliver mortgage products to the capital market. Keeping in mind the risks involved with running a CMO program, lenders can be well compensated for their efforts.

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FREDDIE MAC PCs: ANALYZING COMPETING POOLS

Susan D. Mara

Evaluating generic Freddie Mac trades is complicated by the fact that it is difficult to identify the average characteristics of a Freddie Mac participation certificate. It is not possible to identify a "generic" Freddie Mac security. Any analysis of Freddie Mac PCs should recognize these securities and value them accordingly.

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FOLLOWING THE NEW FANNIE MAE GUIDELINES

Judith Dedmon

An entirely new set of Fannie Mae lender guides will be issued this month. The reasoning behind these changes and its effect on 2,000 lenders are explained in this article.

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ACCRETION BONDS: SALIENT FACTORS

Kurt van Kuller

This article serves as a guide to investors on the factors affecting redemptions and some of the causes of early redemption.

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SPLIT FEE OPTION: INCREASED LEVERAGE AND DECREASED RISK

Richard M. Kaplan, Douglas R. Hiscano, Ernst J. Mikosch and David Weiner

An explanation of the many advantages of the split fee option over the conventional option is provided in this analysis. The split fee option provides an opportunity for the investor to save money in an unfriendly market.

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WHAT THE PRESIDENT'S TAX PROPOSAL MEANS TO REAL ESTATE

Michael S. Salkin and Michael Smith-Heimer

Key provisions on how the President's tax proposal will affect real estate are outlined. The areas addressed are the cost of homeownership, effects on investment properties and property values.

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THE LAST WORD (CALCULATING A RISK PROFILE FOR THE MORTGAGE PIPELINE)

Paul E. Tuttle, Jr.

An approach for valuing a mortgage pipeline of commitments is developed in this article.

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SALIENT FACTORS

The terms "compound interest bonds" or "accretion bonds" refer to all securities in which interest payments are not paid on a current basis to bondholders, but are deferred and reinvested at a compounded rate by the issuer or are substituted for by an accretion of principal at a compounded rate. The Treasury Department treats both cases similarly, defining them as imputed interest. It includes such variations as zero coupons, capital appreciation bonds, some original issue discount bonds and compound coupon bonds. This year, hybrids have been developed which convert to current interest bonds at some future date.

The overwhelming majority of municipal accretion bonds have occurred in housing issues. A special study conducted by Securities Data Company, Inc. (see Exhibits A-D) shows that, in 1984, 85 percent of total accretion bond dollar volume and 77 percent of the total number of issues containing accretion bonds were housing bonds. In 1982, the year of the first modern zero coupon bond (Massachusetts Transportation Authority), those numbers were 78 percent and 86 percent, respectively. Through the first six months of 1985, the housing predominance continued, at 75 percent and 81 percent, respectively. The new convertible issues, not included in the aforementioned 1985 figures, follow the same pattern with 72 percent of their total dollar volume in housing bonds. They also occur much more in single-family than multifamily issues (82 percent of housing accretion bonds in 1984 were single-family issues).

Accretion bonds are ideally suited for housing issues. Internal Revenue Service rules concerning "original issue discounts" make competitive sales of issues containing accretion bonds prohibitively difficult, favoring negotiated sales. The convertible hybrids are especially useful in avoiding the federally imposed debt limitations on annual housing bond volume. Compound interest bonds also offer flexibility in managing outstanding mortgage portfolios in which prepayment irregularities have cropped up by smoothing out debt service. Private developers benefit if they do not have to finance bond discounts. Additionally, mortgage rates can be lowered because accretion bonds are priced at slightly lower yields than comparable term bonds to account for the compounding.

The main advantage of all compound interest bonds is the reduction of total borrowing cost to the issuer. The total interest paid is often mistaken as greater than in current interest bonds due to the compounding effect, but that is more than offset by paying in cheaper future dollars. Furthermore, a properly structured issue will result in a reallocation of the majority of the bond principal from the end of the maturity schedule to the early years. This results in a much more rapid bond amortization and a dramatic reduction in interest payments. This effect is greatest with higher interest rates and rising yield curves. When this effect is efficiently coupled with single-family prepayment redemptions of principal, the results are magnified.

For investors, the main advantage of compound interest bonds, of course, is the reinvestment and compounding of interest at the desirable fixed-rate of the time of purchase. Current interest bond yields (as well as on C.D.s or money market funds) are determined assuming interest is reinvested continually at the initial rate. However, this is, in reality, virtually impossible. It also does not account for managing time and transaction expenses of perennially processing and reinvesting coupons. For this benefit, the investor in accretion bonds sacrifices current income. In addition, at the time of this writing, the supply of compound interest bonds is somewhat heavy, creating undervalued situations. For bond portfolios, such as unit trusts, accretion bonds may be used to lower average prices without disproportionately reducing current return.

Deep discount bonds are also more subject to greater percentage price swings during interest rate shifts.

continued

Kurt van Kuller

Conversely, however, the same changes are much less in absolute dollars than in current interest bonds. The zero coupon market is, however, relatively less volatile because it is more sophisticated.

The major surprise to investors is premature redemptions. This can be dangerous if a premium was paid for the bonds. There is no special redemption risk generic to accretion bonds. Their redemption frequency is no different from other current interest bonds. Housing bonds, however, have experienced many redemptions. The damage from a compound interest bond redemption may be considered greater (on a percentage basis) if it was originally purchased at a price above redemption value plus redemption premium, if any. Therefore, investors in compound interest bonds must beware of housing bond redemptions because accretion bonds are a housing bond phenomenon.

Housing bond redemptions

Tax-exempt housing bonds are subject to several generic types of special redemptions which other types of municipal bonds do not experience. This is due to the nature of the underlying security mortgages. Conversely, tax-exempt mortgage revenue bonds are for the most part protected by federal laws, such as the Mortgage Subsidy Bond Tax Act of 1980 and Section 11(b) of the Housing Act of 1937 from the most prevalent form of extraordinary redemption of municipal bonds—refunding issues. Most housing bonds also have very limited optional redemption features which are rarely utilized. Term maturities in all municipal bonds are usually subject to normal mandatory sinking fund redemptions, of course.

A discussion is necessary to describe the kinds of redemptions possible with both single- and multifamily housing bonds, the associated risks and ways in which these risks are detected and mitigated. Bonds called in these manners are usually always at par or at their compound accreted value, if applicable. Investors suffer a premature return of principal and loss of any premium paid for the bonds above par (or gain of any discount from par). The windfalls achieved by bondholders of other kinds of issues through refundings at premium and advance refundings are, for the most part, not present.

> **"The main advantage of all compound interest bonds is the reduction of total borrowing cost to the issuer."**

Single-family mortgage revenue bonds

Nonorigination redemption: This is far and away the main source of concern among investors. Unexpended proceeds remaining in mortgage acquisition funds must be called after the expiration of the origination period. The reasons for nondelivery, the failure of participating originators (banks, mortgage bankers, and/or the issuing housing authority) to acquire mortgages, are generally superior competition and lack of demand. The vast majority of these redemptions occurred in bonds issued from the last quarter of mid-1981 to Fall 1982, when interest rates reached historic highs. Mortgage rates subsequently dropped 300 basis points in the latter part of 1982. Bonds from this period were locked into offering uncompetitive mortgage rates and consequently, large portions of many of these issues were redeemed throughout the next few years.

This potential for nonorigination always exists if there is a precipitous decline in mortgage rates during the origination period. A substantial partial redemption may produce the unexpected new credit risk of a very small outstanding mortgage portfolio. This may create a lack of geographic dispersion and nonconformity to normal statistical patterns for mortgage defaults and prepayments and an inability to meet fixed expenses (such as those of the servicer, trustee and administrator).

continued

EXHIBIT A

1984 Accretion Issues

PROJECT TYPE	TOTAL (in millions)	PERCENT OF TOTAL $ VOLUME	# OF ISSUES
Airport Facilities	4.155	0.074	1
Educational Facilities	264.942	4.739	14
Hospital Type Unknown	7.780	0.139	1
Hospital General Acute Care	56.066	1.003	4
Industrial Development	16.800	0.301	1
Single Family Housing	3,875.650	69.328	154
Multifamily Housing	857.713	15.343	85
Transportation	37.875	0.678	2
Electric Power Facilities	21.639	0.387	6
Water, Sewer & Gas Facilities	160.735	2.875	20
Other	286.965	5.133	23
TOTAL DOLLAR VOLUME	$5,590.320	100%	311

[illegible]

Kurt van Kuller is vice president and director of municipal research for Moseley, Hallgarten, Estabrook & Weeden Inc. in New York City. Prior to joining the firm, van Kuller was a senior officer in the housing group for Standard and Poor's Corp., where he did analysis and assignment of ratings on municipal housing bonds.

EXHIBIT B

1985 1st Half Accretion Issues Proceeds Totals

PROJECT TYPE	TOTAL (in millions)	PERCENT OF TOTAL $ VOLUME	# OF ISSUES
Housing Type Unknown	3.868	0.119	1
Educational Facilities	85.982	2.644	10
Hospital General Acute Care	85.331	2.624	4
Single Family Housing	1,565.815	48.157	80
Multifamily Housing	874.105	26.883	78
Waterfront/Seaport Facilities	4.061	0.125	1
Transportation	246.717	7.588	3
Electric Power Facilities	171.199	5.265	4
Water, Sewer & Gas Facilities	102.158	3.142	6
Economic Development	0.850	0.026	1
Other	111.389	3.426	6
TOTAL DOLLAR VOLUME	$3,251.475	100%	194

[illegible]

EXHIBIT C

1982 Accretion Issues Proceeds Totals

PROJECT TYPE	TOTAL (in millions)	PERCENT OF TOTAL $ VOLUME	# OF ISSUES
Educational Facilities	73.450	2.498	3
Hospital General Acute Care	349.640	11.892	8
Nursing Home & Life Care Facilities	32.930	1.120	1
Student Loan Programs	13.050	0.444	1
Single Family Housing	1,483.173	50.446	45
Multifamily Housing	813.636	27.673	62
Transportation	68.270	2.322	2
Water, Sewer & Gas Facilities	105.985	3.605	3
TOTAL DOLLAR VOLUME	$2,940.134	100%	125

[illegible]

EXHIBIT D

1985 1st Half—Convertible Issues (Gains, Stairs, Etc.) Proceeds Totals

PROJECT TYPE	TOTAL (in millions)	PERCENT OF TOTAL $ VOLUME	# OF ISSUES
Educational Facilities	32.874	5.021	1
Hospital General Acute Care	29.162	4.454	3
Single Family Housing	392.177	59.897	13
Multifamily Housing	78.582	12.002	5
Transportation	72.112	11.014	2
Electric Power Facilities	49.847	7.613	2
TOTAL DOLLAR VOLUME	$ 654.754	100%	26

[illegible]

The length of the origination period, varying between indentures, issuers and states, usually ranges from six months to three years.[1] During this time, the undisbursed mortgage money remains in securities or in an investment agreement designed to at least meet debt service and issue expenses. Occasionally, extension provisions are present in indentures, but a new investment agreement or additional money from outside sources often would be required to pay bond expenses for the extended time due to interest rate changes. Large housing authorities with capable staffs often have at their discretion the flexibility to redeem bonds from unused proceeds on several different dates within the origination period.

Restrictions on disbursements: These have a significant impact. A fixed draw schedule, due to the nature of the acquisition fund investments, may be in place. Quite common is the allocation of monies between originators, some of whom may not meet their anticipated goal. Their past experience should be examined by investors. More restrictive are builder reservations, common in California, in which the funds are tied to sales at specific developments. Reallocation to successful originators or a change to a "first come—first serve" basis after some interval reduces redemption risks. Nonrefundable commitment fees may provide servicers with extra incentive and provide necessary funds for nondelivery redemptions. Lifting of restrictions to geographic areas (such as counties, cities or certain Census tracts) is also a positive.

Between 20 percent-40 percent of each SFMRB (single-family mortgage revenue bond) must be delegated to low-income HUD-approved targets areas for one year, if any exist. Often, issuers may impose further area restrictions to benefit depressed sectors. Federal requirements have also greatly increased the administrative processing time for underwriting mortgages from tax-exempt bonds.

Demand: Projections must isolate the first-time homebuyer market and determine the capture ratio of the total estimated market that the issue is attempting to attain. Federal law limits 90 percent of the acquisition fund purchases to mortgagors who have had no ownership interest in a principal residence during the prior three years except in targeted areas. Purchase prices are also capped at 110 percent of average area prices (120 percent in targeted areas). Issuers often impose additional underwriting standards and income limits which can decrease the pool of mortgagors.

The types of mortgages offered (i.e., GEMs, ARMs, rehabs, home improvement loans, construction financing), the downpayment provisions and total points charged also affect their attractiveness. Limits on types of homes to be financed (townhouses, developments, condos, co-ops, two- to four-units, mobile homes, etc.) are often incorporated. Demand studies, by recognized consulting firms, should be carefully studied for underlying assumptions. Local housing conditions such as conditions of housing stock, conversion, vacancy rates, etc., should be considered. New housing construction below price limitations is important to meet first-time home buyer demand. Some issues have limited the amount of mortgages on existing homes versus new construction.

The economy of the region, cyclical and diverse in demographics, should be examined. Unforeseen local events such as flooding, moratoriums on water or sewer connections, bank closings, etc., may hamper originations. Current and future competition from other financing sources, including other tax-exempt bonds in adjacent areas, FHA and VA rates may have an impact on delivery. Comparisons should consider other factors such as downpayments, buydowns, subsidies and points, as well as rates. The track record of past issues in the area can be a useful demand indicator. The level of requests by originators and subsequent commitments for mortgage money is an important yardstick.

Mitigating factors: During the origination period, if full delivery appears doubtful due to a sharp interest rate decline, it may be possible to meld the issue with proceeds of a new cheaper one or with other external funds. State agency issuers are more likely to have this capability to lessen redemption risk as well as having wider geographic dispersion of mortgages. Dilution of the credit strength of the outstanding bonds is a concern of an open lien, which must be weighed against the benefits of a seasoned portfolio. Housing authorities with ongoing programs and sizeable staffs, however, would usually prefer any alternative to a major nonorigination redemption. Limits on annual housing bond volume may, of course, hinder this technique. Bondholder approval may be necessary for additional bonds or modification of underwriting standards. Issues may achieve slightly lower expected rates by opting to credit mortgagors any excess arbitrage earnings, rather than sending such funds to the United States Treasury. Rare issues that are structured assuming prepayments to meet debt service or those with mortgage forgiveness can produce slightly lower mortgage rates.

> **"For investors, the main advantage of compound interest bonds, of course, is the reinvestment and compounding of interest at the desirable fixed-rate of the time of purchase."**

Prepayment redemptions: Premature recoveries of mortgage principal are usually caused by mortgagor refinancings, partial prepayments, foreclosures, mortgage insurance collections and property damage insurance proceeds. The broad areas are often lumped together and significantly reduce the life of a bond issue. It should be noted that prepayments may affect the cash flow coverage and surplus levels of individual bond issues positively or negatively, due to priority calls and interest rate structures.

Factors affecting prepayments: One main determinant of a mortgagor's intentional prepayment is the attractiveness of the mortgage. Many of the bonds sold during the highest interest rate periods, after possibly experiencing large nonorigination calls, are now faced with rapid prepayments because of the onerous underlying mortgage rates. Assumability of mortgages in the portfolio is also a major factor. Other legal restrictions may be in place. Prepayment penalties during the early years of a mortgage can have some impact.

Other influences are income levels, mortgagor age and upward mobility, general economic conditions, social and demographic trends, the local housing supply and appreciation rates and major employer dislocations. A mortgage forgiveness program (cancelling remaining mortgage debts after all bonds are retired) may encourage mortgagors to hold out longer. Foreclosure laws and mortgage insurance policies will influence whether defaulted mortgages are paid off in full or assumed by insurance companies.

Prepayment statistics on various types of mortgages have been shown to vary significantly between geographic regions. Generally, southern states such as Texas, Arkansas, the Carolinas, Virginia and Georgia experienced some of the fastest rates in the nation in recent years, although Louisiana, Florida and Oklahoma were at national averages. Certain Midwestern states such as Missouri, Kansas, Illinois and Nebraska were also among the highest, while Michigan was low. Among those with the slowest rates in the nation were Washington, Oregon, Arizona and New York. Puerto Rico was even slower.[2] However, these results may change radically over short time periods and by comparisons of different kinds of mortgages. Dramatic differences between cities and counties also occur.

Predicting prepayments: There is no foolproof methodology for forecasting prepayments on mortgages purchased by tax-exempt, single-family mortgage revenue bonds. Not only is there an insufficient historic record and no central information gathering source, but swings in prepayment patterns have been detected in recent

continued

years for all home mortgages. Cash flow projections required by rating agencies have utilized FHA experience (see Exhibits 1 and 2) with some much older issues run on a GNMA (12-year average life) index.

The 1980 Ullman bill mandates a 100 percent local FHA experience run to estimate arbitrage earnings. FHA mortgagors are similar perhaps in income levels, but are not necessarily first-time homebuyers subject to prepayment penalties and subsidized by tax-exempt rates. FHA loans are assumable and have lower downpayment requirements. The FHA index, although it accounts for the age of loans, has certain drawbacks. It does not adequately address different coupon rates in various market scenarios and it has been updated almost annually with some substantial revisions.[3] Only 15 of the 30 years of data are actual. The rest is estimated.[4] Furthermore, FHA statistics do not give information on partial prepayments and their dollar value. Cancellation of FHA insurance policies, other than defaults or total prepayments, may also slightly skew the index.

A few municipal issues have provisions to sell off remaining mortgages and redeem bonds when the portfolio reaches a very small level. Rating agency requirements of zero prepayment runs and extremely rapid three-year average life tests give the investor some comfort. Perhaps the newly developed PSA standard prepayment model would be an improvement because it smooths over disjointed annual shifts in FHA prepayments. If possible, investors are recommended to examine the experience of past bonds of the issuer or similar ones.

EXHIBIT 1

Survivorship and Decrement Table as of December 31, 1983 for FHA-Insured (Section 203) 30-year Home Mortgages Insured since 1970

	Survivors at Beginning of Year	Terminations During Year	
		Claims	Nonclaim (Prepayments, etc.)
1	100%	707%	1.38%
2	97.9	1.965	3.71
3	92.2	1.433	4.36
4	86.4	917	4.12
5	81.4	612	4.20
6	76.6	434	4.40
7	71.8	362	4.12
8	67.3	308	4.00
9	63.0	234	3.87
10	58.9	160	2.91
11	55.8	146	2.43
12	53.2	111	2.25
13	50.9	079	2.21
14	48.6	049	2.20
15	46.3	022	2.15
16	44.2	019	2.08
17	42.1	017	2.00
18	40.0	015	1.90
19	38.1	013	1.80
20	36.3	012	1.69
21	34.6	010	1.58
22	33.0	009	1.75
23	31.3	007	1.88
24	29.4	006	1.98
25	27.4	005	2.05
26	25.3	004	2.07
27	23.1	003	2.07
28	21.2	002	2.03
29	19.2	001	2.62
30	16.5	001	16.54

[illegible]

Recycling: Many issuers have the flexibility within bond indentures to reuse recoveries of principal to purchase additional mortgages which meet program guidelines rather than redeem bonds. This may, in some cases, effectively bypass prepayment redemption risk for investors. Rating agencies view the practice as a negative credit characteristic mainly because of the potential for portfolio dilution. Also, the high coupon bonds experiencing the most rapid prepayments would require underwriting noncompetitive mortgages. The most effective use of this technique is made by state agencies (such as the Connecticut Housing Finance Authority) with large staffs and with other outstanding bonds from which all prepayments may be blended. The result is that new mortgages need cover only the average weighted bond interest cost. The redemption risk is thus lowered contingent upon the success of the recycling program. This activity has become more attractive to issuers since imposition of bond volume restrictions.

More solutions: Reinvestment into securities sufficient to pay debt service, if possible, would preempt redemptions. Treasury regulations, of course, severely limit this ability. Purchasing bonds on the open market is another alternative, but one that is not particularly advantageous to bondholders. That is because such activities are usually secretive and issuers would offer no premium.

Other redemptions: Surpluses from float and interest income may be treated similarly to prepayments or may revert outside the issue to the housing authority. Although considered a negative for bond ratings, an open indenture can reduce redemption frequency. Certain issues also have extra large reserves which are used to call bonds at a fixed date or periodically through reductions tied to the outstanding mortgage portfolio. Older issues were permitted to use up to 15 percent of proceeds for reserves while others were contributed from outside sources. Many indenturers also allow a

continued

EXHIBIT 2

Claims for FHA-insurance and prepayments on all single-family mortgages endorsed, by year of endorsement:

Endorsement Year	Claims Rate	Prepayment Rate
1976	3.1%	26.1%
1977	2.3	15.8
1978	2.7	7.4
1979	3.7	3.1
1980	5.1	3.8
1981	7.6	12.8
1982	2.9	12.7

[illegible]

total redemption toward the end of the bond's life if reserves on-hand equal or exceed liabilities. Senior lien bonds may have redemptions triggered by defaults on subordinated issues. Issues convertible from accretion bonds to current interest bonds at a future date usually are subject to an optional call at that time.

Multifamily mortgage revenue bonds

The risk of all premature redemptions of multifamily housing bonds is relatively minimal and should be differentiated sharply from SFMRBs. In fact, since refunding bonds are not allowed, multifamily issues must rank among the least likely of all municipal bonds to be called. Let us review the kinds of possible multifamily bond redemptions, recognizing the greater variety of subsidy programs and tax laws (e.g., Section 11[b] of the National Housing Act vs. Section 103[c] of the Internal Revenue Code), the presence or lack of certain insurance policies and whether the bonds are a state agency obligation or a local deal. Investors should also be cognizant of substantial differences that may exist in special and developing types of issues such as LOC-backed, insured, collateralized or "Muni-Mae" issues.

Noncompletion: In most cases, this is synonymous with minimal construction risk. Another rare possibility would be a major interest rate rise which kills project feasibility. The construction period is limited by the indenture to a reasonable fixed date, after which bonds are subject to a mandatory par call if certain conditions regarding completion have not been satisfied. The bond proceeds remain in escrow during this time, invested in U.S. Government bonds or pursuant to an investment agreement. Failure by HUD to grant "final endorsement" due to faulty construction or breach of other contractual provisions is the usual trigger for this type of redemption in FHA-insured issues. Unforeseen cost rises can usually be met by completion bonds, cash infusion from owners, fixed price contracts, performance bonds, letters-of-credit and a 10 percent retainage reserve of construction funds. Limited extensions of the construction period and even commencement of mortgage amortization are obtainable, if funds available are sufficient to meet bond debt service and other expenses.

Occasionally, construction financing is funded by bond proceeds in certain FHA-insured deals. Each advance for construction spending must be FHA-insured, so that if the project is never built, the bonds are redeemed from insurance proceeds. In other instances, uninsured Section 8 may be bonds issued after projection completion for take out of construction of other prior financings, so that the risk is nonexistent. State agencies often have incorporated the right of substitutability of projects in indentures. That enables them to transfer bond proceeds to a long list of other suitable projects in the event of noncompletion. Thus, various state agency issues bear virtually no noncompletion redemption risk. Section 103(c) of the Internal Revenue Code, however, limits the unrestricted arbitrage period for multi-

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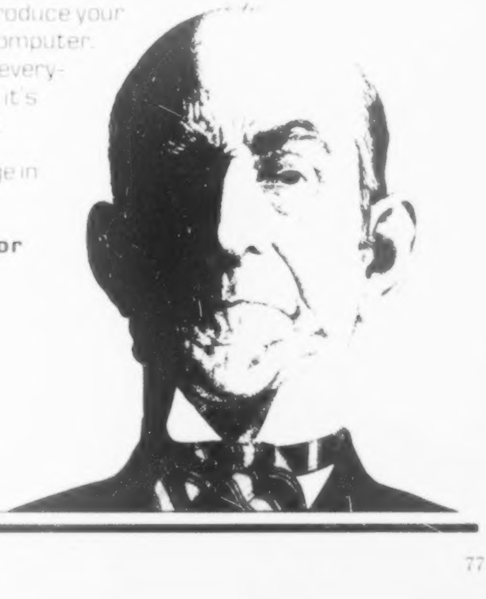

family bonds to three years, but does not mandate redemptions.

Reduction of mortgage: Quite often there is a relatively minor redemption after cost certification in "stand-alone" deals (i.e., local or an agency issue not commingled with other project financings) from unused bond proceeds. HUD will reduce the mortgage amount if the construction costs come in lower than expected, so it is necessary to redeem a corresponding amount of bonds and proportionally reduce reserves. These surpluses should not be reinvested because of arbitrage rules and long-term investment risk. Lower costs could occur due to conservative budgeting and competitive construction markets. A related development at cost certification is the determination that insured construction advances were used for ineligible costs. The mortgagor must produce these funds for redemption of a ratable amount of bonds or face a default.

FHA insurance proceeds:[5] In the event of a default, insured mortgages are assigned by the trustee to FHA in "stand-alone" deals and some state agency issues. The insurance proceeds are used to meet an acceleration of bonds. The debt service reserve in these single-project issues must not be drawn down until after the assignment to FHA. Insured local issues, which, unlike uninsured issues or many state agency issues, allow no work outs of troubled projects, therefore, have a somewhat greater chance of premature redemption as a trade-off for security of principal. A minor cure period, however, is present in some indentures so that the assignment can be halted in the event of full restitution. Section 221(d)(3) and (d)(4) programs allow HUD to grant operating loans during the first two years after project completion. Some other programs allow FHA to opt to payoff in debentures precluding redemptions.

The default rate on FHA-insured multifamily mortgages varies considerably over time according to the particular insurance program. Most municipal bonds were used in conjunction with Section 221(d)(3) and Section 221(d)(4) of the National Housing Act. The Section 221(d)(3) program for nonprofit and cooperative mortgages will insure up to 100 percent of project replacement cost of new construction. Section 221(d)(4) for private owners will insure up to 90 percent, requiring an equity contribution for the remainder. The Section 221(d)(3) projects, begun in 1954, are divided almost evenly between those made at below-market rates (BMIR) or at market, although the BMIR program has been inactive since 1972. HUD statistics[6] show that 32 percent of BMIR projects have applied for FHA insurance compared with 18 percent of market rate 221(d)(3)s. However, the 221(d)(3) market rate insurance claims decreased drastically by 1975, with none since 1977.

More than half of Section 221(d)(4) projects are subsidized. The nonsubsidized 221(d)(4) claim rate is 16 percent, but subsidized projects have a low 2 percent rate. The vast majority of all 221(d)(4) claims occurred in the 1970s. Section 223(f), which includes a coinsurance program for GNMA-collateralized bonds, has a low 3.4 percent claim rate since its inception in 1975. Some older multifamily bonds include projects under the Section 236 program, which was active from 1968 to 1973. However, not all issuers opted for the mortgage insurance as well as the deep interest rate subsidy (e.g., Massachusetts Housing Finance Agency). The claims rate on this troubled program is 18.5 percent.

Prepayments: Optional mortgage prepayments by private owners of Section 8 projects financed by tax-exempt 11(b) bonds have been very rare to date. Most of these issues, whether or not insured or collateralized, have lengthy optional call protection at significant premiums incorporated into the bond indenture as a major deterrent. Furthermore, 11(b) refunding bonds are prohibited by HUD and private sources for refinancing have not had sufficient economic justification.

However, at some point in the future, taxable rates on HUD regulations may become more amenable. Furthermore, the tax benefits for most owners of most Section 8 projects should dry up by the end of this decade. (Section 8 contracts were renewable on 5-year terms from 1974 to 1979. Since then, they have been for 20-, 30- or 40-year terms.) However, conversions to co-ops or cancellations of Section 8 contracts are unlikely to

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attain necessary HUD approval or overcome local laws and political obstacles. More likely would be conversions to public ownership.

It is also possible for owners to refinance bonds of this type to remove certain onerous 11(b) restrictions and still leave the Section 8 contract intact.[7] HUD's concerns center on the perpetuation of low-income elderly housing, not on the financing. In fact, a reduction of debt service, if achievable, would reduce the Section 8 subsidy payable by HUD.

Underlying tax-exempt mortgages can also be sold to savings banks, usually without HUD approval, with sales proceeds available to redeem bonds. FHA-insured issues during the high interest rate era which included a financing adjustment factor to raise allowable mortgage rates also incorporated provisions in indentures for refundings. It should be noted that if the multifamily project is publicly-owned (like all non-Section 8 programs), the possible incentives for prepayments are nonextant. Also, as seen elsewhere, state agencies often have much latitude with the disposition of principal recoveries. Each issue must be analyzed on a case-by-case basis, however, because certain "stand-alone" projects receive virtually no support from the state agency which may be the nominal issuer of the bonds.

Surpluses: Operating surpluses in these types of projects are rarely significant. Projected coverages of 1.10x debt service, including reserve fund earnings, are considered high. Much of the surpluses can be funnelled out of the indenture to the private owner or the housing authority. Again, state agency issues with open indentures may experience many fewer redemptions. Greater surpluses are sometimes seen as a result of excess construction note interest earnings which are transferred to bond accounts after final endorsement in FHA-insured deals.[8] This money could be used to redeem bonds, or as a reserve held by trustees or may be taken outside the deal. Surplus redemptions are also mitigated by the practice of releasing letters-of-credit or owner deposits, put up to fund required reserves, when funds on-hand are sufficient.

Other redemptions: Multifamily bonds contain provisions for partial or total redemption from proceeds of casualty insurance and condemnation awards, if not used to restore the property. Most issues allow a total redemption if the trustee has sufficient funds on-hand, including the debt service reserve, to redeem all outstanding bonds late in the life of the issue. Certain reserves based on percentages of outstanding debt are incrementally reduced and used for bond calls. Again, state agencies may have the flexibility to reuse these monies. Collateralized issues generally have provisions for mandatory redemptions if the value of the collateral falls below designated levels. GNMA-collateralized issues usually have redemptions from prepayments on GNMAs, which can be significant. Letter-of-credit backed issues often have mandatory redemptions if the LOC is not renewed continually. Cross-default provisions may exist in issues secured by multiple multifamily mortgages, whereby a default on one mortgage triggers a mandatory redemption of all bonds. Some state agency multifamily issues that are tax-exempt under Sections 103(b) and (c) may be refunded, subject to state laws and agency programs. Of course, term bonds are also subject to a mandatory sinking fund.

Redemption features

Prioritized calls: Assessing the priorities of bond maturities within an issue in the event of a partial call is an important aspect in determining the probability of a premature redemption. Housing bonds commonly attempt to deal with the prepayment problem and surpluses by funnelling these funds into certain maturities called "super-sinkers." Those maturities are sold to investors who prefer prepayments, causing the remaining bonds to be less vulnerable to calls.

Conversely, some maturities (often compound interest bonds), for marketing reasons, are the last called. The same bonds, for other kinds of partial redemptions, such as nonorigination or insurance proceeds, are usually subject to "strip calling," (i.e., *pro rata* redemptions) among bonds of all maturities. If this is not present, the danger exists that the reduced, level mortgage payment stream securing the bonds would be mismatched with a

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lumpy debt service schedule. Mortgage payments may then be too low in some years to cover debt service. The effects of priority calls from prepayments in single-family bonds are, therefore, necessary to analyze in cash flow projections under various scenarios to ensure that the bonds will be paid off.

The variable factors in the cash flow runs are delivery rate, prepayment rate and lag in receipts of payments by trustee. A "super-sinker" run, for example, will burn out the super-sinker at a three-year average life rate, then revert to zero prepayments for the remaining life of the bonds. A call protected CAB (capital appreciation bond) run conversely, assumes rapid prepayment of all other maturities and then reverts to zero for the CABs. In multifamily issues also, the indenture should require that bonds may be priority-called only to the extent that it does not impair ability to pay debt service. Even surplus monies from interest earnings may be needed to pay debt service in future years. Most of the time, a priority call works best when the super-sinker or call-protected maturities are not a large percentage of the total issue.

Other features: Minimum call restrictions (ranging usually from $25,000 to $250,000) may have an impact on timing of calls. Bonds should be chosen by lot even among the various bonds in different maturity classes. Some state agencies have at their discretion the ability to call bonds with the highest coupons. Bonds may also be subject to the senior or subordinated lien of another issue (usually concurrently sold) which may prioritize certain types of redemptions. □

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[1] Section 103(A) of the Internal Revenue Code specifically exempts excess arbitrage earnings on mortgage acquisition funds for only one year (1½ years for targeted areas). There is no legal limit on the origination periods; however, if issues can survive by outside contributions or within the permanent arbitrage restrictions. One exception is specific Puerto Rican housing issues, which were exempt from the arbitrage regulations prior to 1984 and have five-year origination periods, as well as additional extensions.

[2] From Salomon Brothers statistics on seasoned discount FHLMC and FNMA pools. FHA regional prepayment records are not regularly published.

[3] It has been estimated that the average lives of mortgages can vary by 15 percent between different percentage runs of 1981 FHA and 1983 or 1984 FHA.

[4] HUD researchers believe that actual dates from the years 1957-1968 were inapplicable.

[5] A very small number of multifamily bonds are secured by mortgages with private insurance companies, such as TICOR. Provisions of these issues may vary case by case.

[6] Through April 30, 1984 from HUD; nonclaim terminations excluded, of course.

[7] Some examples of regulations imposed by Section 11(b) and not the Section 8 contract are: trustee possession of all revenues, requisitioning of trustee for operating expense, surpluses trapped in debt service reserve remitting to HUD, certain required insurance policies.

[8] This occurs in the FHA bonds issued concurrently with FHA notes, which is very common for construction financing.

WHAT THE PRESIDENT'S TAX PROPOSAL MEANS TO REAL ESTATE

In June 1985, the United States Department of the Treasury announced its second plan for tax simplification and reform. The plan is commonly referred to as Treasury II or the President's tax proposal.

If the proposal were to become law, the key questions of interest to the real estate community are: ▪ What would be the impact on the cost of homeownership? ▪ How would the proposed changes affect investment properties? ▪ What would happen to property values?

In order to assess the impact of the President's tax proposal on the real estate industry, the various provisions were separated into those affecting owner occupants and those affecting real estate investors.

Owner occupants

The tax treatment of owner-occupants under Treasury I and the President's proposal is virtually identical. The only differences are in the definitions of the tax brackets and size of the zero bracket amount. As with the original tax proposal, three key provisions of the President's proposal will increase the cost of homeownership.

Loss of property tax deduction —The loss of property tax deductions on federal income taxes would directly raise the after-tax cost of homeownership. In states like California where house prices and property taxes are higher than average, this provision would be particularly painful and could depress house sales and prices in the short run.

Reduction of marginal tax brackets—Because the President's Proposal would reduce the number of tax brackets, many homeowners would fall into a lower tax bracket. Consequently, even though their mortgage interest payments would still be deductible, the value of the deduction for these owners would be less, resulting in an increase in homeownership costs.

Doubling of the personal exemption—The personal exemption would be increased in 1986 from $1,080 to $2,000. Again, while this does not directly affect ownership costs or house prices, the increase would effectively reduce the value of the mortgage interest deduction and help raise the after tax cost of owning a home.

Real estate investors

The President's Tax Proposal treats investors much less severely than Treasury I. The most onerous provisions in Treasury I have been removed, and other provisions that would increase the cost of owning investment real estate have been softened.

Replace ACRS with CCRS—Under the current Accelerated Cost Recovery Depreciation System (ACRS), property is depreciated over an 18-year period. For residential property, an accelerated system of depreciation is permitted. An owner can deduct 175 percent of the amount allowed using straight line depreciation rules resulting in depreciation in earlier years being greater than in later years. For instance, on a $100,000 property, the value of the first year depreciation is $100,000/18 × 1.75, or roughly $9,700. In subsequent years, the approximate value of the depreciation is $9,000, $8,000, and so forth.

The President's proposal will replace ACRS with the Capital Cost Recovery System (CCRS). The essence of this change is two-fold. First, the useful life of the property would be extended from 18 to 28 years. Second, the cost basis of the structure would be indexed for inflation. Consequently, the proposal would push depreciation deductions into the future, reversing the current system of larger deductions in early years. However, unlike ACRS, during periods of rapid inflation, depreciation allowances would increase over time. Because of this, property owners would gain greater income during the holding period through the increased depreciation allowance. This, in turn, would help offset rent increases.

In addition, the President's proposal would revise the way costs incurred during construction are recovered. Currently, interest costs and taxes paid during construction are amortized at 10 percent annually. The President's proposal would require the investor to include these costs in the depreciable basis of the property, thus extending the recovery period from 10 years to 28 years.

Revised capital gains treatment of real estate—Presently, the top capi-

By Michael S. Salkin and Michael Smith-Heimer tal gains tax rate is 20 percent. The President's proposal would reduce the rate to 17.5 percent. However, depreciable assets, including real estate, would not be eligible for the capital gains tax rate. Instead, the gain from the sale of a building would be adjusted for inflation and essentially taxed at ordinary tax rates.

One advantage of this method is that the tax on the sale of a property exclusive of land would be due only if the asset increases in value in excess of the rate of inflation. If the value of the building increases at the rate of inflation or below it, then the inflation-indexed value of the property would equal or exceed the sales price, creating a loss for tax purposes at the time of sale.

Eliminate favorable tax treatment of residential real estate—Under current law, residential investment property is given special attention. ACRS permits an accelerated rate of depreciation. When a residential investment property is sold, the taxpayer must report the portion of the depreciation allowance claimed during the holding period that exceeds straight line depreciation as ordinary income. This permits the owner of the property to use the income from the "excess" depreciation for the holding period, gaining use of the money for a number of years.

Under the terms of the President's proposal, the preferential position given residential real estate would be eliminated. Because all property owners must utilize the same depreciation methods, the relative after-tax value of residential real estate will decline, dampening investment in residential properties.

Limit deductibility of interest costs—Current law divides interest costs into three categories. *Consumer* interest on automobiles, vacation homes, boats, etc. and *business* interest from the operation of a business are fully deductible. *Investment* interest, however, is not fully deductible. It is limited to $10,000 in excess of the investment income received by the taxpayer.

The President's proposal would limit the deductibility of interest costs. The limitation will be enacted in two phases. During the first phase, the $10,000 cap on investment interest would be reduced to $5,000. This would occur before 1988.

During the second phase, the interest limitation would be expanded to include consumer interest and limited partnership interest. All consumer interest, with the exception of interest on the taxpayer's principal residence, would be subject to the $5,000 cap. Interest costs from a limited real estate partnership, where the taxpayer is a limited partner, also would fall into the expanded definition of investment interest.

The treatment of consumer and limited partnership interest costs as investment interest subject to the cap would be phased in over a 10-year period at an increase of 10 percentage points per year. For example, in taxable years beginning in 1986, 10 percent of consumer and limited partnership interest costs would be subject to the limitation. In 1987, 20 percent of the investment interest would be subject to the limitation. In each subsequent taxable year, the percentage would be increased by 10 percentage points until the change was fully phased in.

Extend the "at-risk" limitation on business losses to real estate—If a real estate loan is secured only by the property with the lender having no recourse for the loan value through the personal assets of the borrower, the losses claimed for tax purposes on the investment can equal the value of the

Table 1

Impact of President's Tax Proposal on After Tax Cost of Occupancy

		After tax cost of occupancy under:				
	Gross Income*	Current Tax Law	President's Proposal	Additional After Tax Cost	Decline in Home Value**	Percentage Decline in Home Value
$85,000 house						
Single	$32,238	$10,544	$11,582	$1,038	$ 8,797	-10.3%
Married couple	32,238	11,395	12,340	945	8,009	-9.4
Married couple Two children	32,238	11,488	12,340	851	7,215	-8.5
$115,000 house						
Single	43,616	13,466	15,414	1,948	16,505	-14.4
Married couple	43,616	14,454	15,689	1,235	10,462	9.1
Married couple Two children	43,616	14,610	15,792	1,182	10,014	-8.7
$250,000 house						
Single	94,817	25,945	30,351	4,406	37,338	14.9
Married couple	94,817	27,532	30,851	3,319	28,124	11.2
Married couple Two children	94,817	27,628	31,251	3,623	30,703	12.3

* The above figures represent the effect on taxpayers with only homeowner [illegible]. Figures may not be exact due to rounding.
** The decline in property value occurs from capitalizing the additional yearly after tax ownership cost over the life of the property.

property. This is allowed even though the investor only has "at-risk" the down payment and income generated by the property. Current regulations state that real estate loans do not need to meet at-risk requirements. However, under the President's proposal, if the at-risk requirements are not met, losses would be limited to the equity and income earned from the property.

Due to existing law, it is not clear whether residential property in California of four units or less can meet the at-risk requirements. This will severely limit the amount of financial exposure homeowners can be legally subjected to by lenders. The Treasury acknowledges that there are potential legal problems with the proposal and recommends that states amend existing legislation to address the legal road blocks.

One of the major reasons the demand for real estate has been so large in recent years is that investors have not been subjected to at-risk limitations. Consequently, the ability to post taxable losses in excess of the amount of capital tied up in the project has added value to the project.

Financial impact on owner-occupants

The President's proposal would cause the after-tax cost of homeownership to rise, but total income tax paid would decline, resulting in an increase in disposable income. Property values would decline 10 percent, at most, depending on the value of the house and the degree to which the increase in costs are capitalized into prices.

This conclusion is based on a comparative tax analysis of three house purchases with values of $85,000, $115,000, and $250,000. It was assumed that each owner spent 28 percent of their gross income on principal and interest payments. It also was assumed that the taxpayer had no other deductions and that the house was the only investment present. In addition, calculations were made based on occupancy of each house by a single person, a childless couple, and a family of four.

As shown in Table 1, in all cases the combined effect of the loss of property tax deduction, increase in zero bracket amount and reduction in marginal tax rates by the President's proposal would raise the after-tax costs of homeownership.

For example, to the family of four living in a $85,000 house (the median price in the U.S.), the costs of owning a house would increase 7.4 percent or $851 per year. For the $115,000 house (the median price in California), the same family would incur a cost increase of 8.1 percent or $1,182 annually.

> "Although the top tax rate drops to 38 percent, the rate brackets for most middle income Americans fall relatively little."

The increased homeowner costs were partially offset by a rise in disposable income. In the absence of the other provisions of the President's proposal, revised marginal tax rates generally decreased the level of tax paid. For instance, disposable income increased by about $196 or 0.7 percent for the owner of the $85,000 house, and $618 or 1.6 percent for the owner of the $115,000 house. The reduction in tax obligation is due to the doubling of personal exemptions, the lower taxable income and the taxing of income at substantially lower rates. Table 2 highlights changes in the taxes owed by various taxpayers and the resulting increases in disposable income.

Because the costs of ownership would increase under the President's proposal, property values would potentially fall. The decline would depend on the extent to which costs are capitalized into house prices. If 100 percent capitalization was assumed—an extremely high rate—then the $85,000 house occupied by the family of four would decline in value $7,215 or 8.5 percent, the $115,000 house would drop in value $10,014 or 8.7 percent, and the $250,000 house would fall in value $30,703 or 12.3 percent. In all cases a discount rate of 12 percent was assumed. This rate reflects the "opportunity cost" of carrying debt on 80 percent of the property combined with the return the taxpayer would expect, if instead of buying a house, the down payment was placed in a safe investment.

If 100 percent capitalization does not occur (the most likely event), then values would decline less. In addition, the change in property value depends on overall levels of demand, and on how owners spend the increase in disposable income gained from the lower tax bite. The demand for housing may actually increase because, relative to all other investments, the tax advantages of homeownership may still be superior. If this situation emerges, the demand for housing will rise and property values will increase. In fact, it is possible that the demand for large expensive houses would increase the most because equity in these houses can be used for a variety of other purchases.

Given that the longer-term effects are impossible to predict, it is safe to conclude that in the short run the rising after-tax costs of homeownership will lead to some reduction in property values. However, the decline will likely to be very small and short lived for homeowners living in median-priced houses. As the demand for expensive houses increases, house prices are likely to rise.

Financial impact on real estate investors

Property values could decline approximately 10 percent as a result of the changes in the tax laws governing investment property. Construction of rental units would drop and rents would eventually rise to offset the increased operating costs.

To arrive at these conclusions, an

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analysis was undertaken of the construction, operation and ultimate sale of a 12 unit apartment building. Assumptions were made regarding construction costs, rents, land costs, site improvements, etc. The rate of inflation during the holding period was assumed to average 6 percent. Estimations of after-tax cash flows, after-tax return on equity (ROE), and internal rates of return (IRRs) were made for both current tax law and the President's proposal.

Under the President's proposal, annual after-tax cash flows achieved from holding the property remained positive throughout the holding period but were generally below after-tax cash flows under current law. Not until the 10th year of the project-life did the annual cash flow exceed that achieved under current tax law.

The proposed change from the Accelerated Cost Recovery Depreciation System to the Capital Cost Recovery System would cause the majority of the cash flow reductions. For example, assuming the building were constructed at a cost of $664,000, held for 15 years, and sold for $1.5 million, the net present value of the tax savings achieved from depreciation expenditures would decline from $132,739 under current law to $71,570. As a result of this reduction, a modest 10 percent decline in the value of the project would occur.

> "From all appearances, it looks as though tax reform as applied to real estate is an attempt to turn the clock back and return to the tax laws that existed prior to 1981."

The President's proposal does offer investors an advantage when the property is sold, however. Indexing the property basis to inflation reduces the taxable gain at time of sale. The reductions in the after-tax cash flows are offset by the lower tax paid under the President's proposal as opposed to current law. In the example cited, the after-tax cash from a sale based on the President's proposal exceeded current tax law by nearly $75,000 if the property is sold in the third year, and this differential continues to increase throughout the first 15 years. In the 15th year, the after-tax cash received from the property would exceed current law by $315,000.

The relative value of the investment depends on the amount of equity contributed to project development. Four separate equity levels were examined, ranging from an all-equity project down to a 10 percent equity project. Figure 1 shows the relative project returns based on this range of equity levels.

At equity levels below 50 percent, the President's proposal induces slightly inferior internal rates of return. However, at equity levels above 50 percent, the President's proposal offers marginally higher investment results. If the project is financed through 100 percent equity, the President's proposal offers IRRs up to 10 percent greater than rates under current law.

The after-tax return on equity for the project reveals a similar pattern. In general, during the first nine years the current tax law provides a greater return on investment. While an all-equity project performs significantly better under the President's proposal, the

Table 2

Impact of President's Tax Proposal on After Tax Disposable Income

		Income tax under			
	Gross Income*	Current Tax Law	President's Proposal	Increase (Decrease) in Disposable Income	Percentage Increase (Decrease) in Disposable Income
$85,000 house					
Single	$32,238	$ 3,664	$ 3,842	$(178)	(0.6)%
Married couple	32,238	2,955	2,911	42	0.1
Married couple Two children	32,238	2,507	2,311	196	0.7
$115,000 house					
Single	43,616	5,648	5,908	(260)	(0.7)
Married couple	43,616	4,696	4,418	278	0.7
Married couple Two children	43,616	4,139	3,521	618	1.6
$250,000 house					
Single	94,817	17,927	17,978	(51)	(0.1)
Married couple	94,817	15,449	13,713	1,736	2.2
Married couple Two children	94,817	14,591	12,713	1,878	2.3

*The above figures represent the effect on taxpayers with only homeowner deductions. Assumes principal and interest payments are equal to 28 percent of gross income. Gross income is derived from monthly payments. Figures may not be exact due to rounding.

> "In all likelihood, if real estate tax reform occurs at all, the real estate industry will lose precisely what it gained as a result of the 1981 Economic Recovery Tax Act."

ROE still remains below current levels during the first seven years.

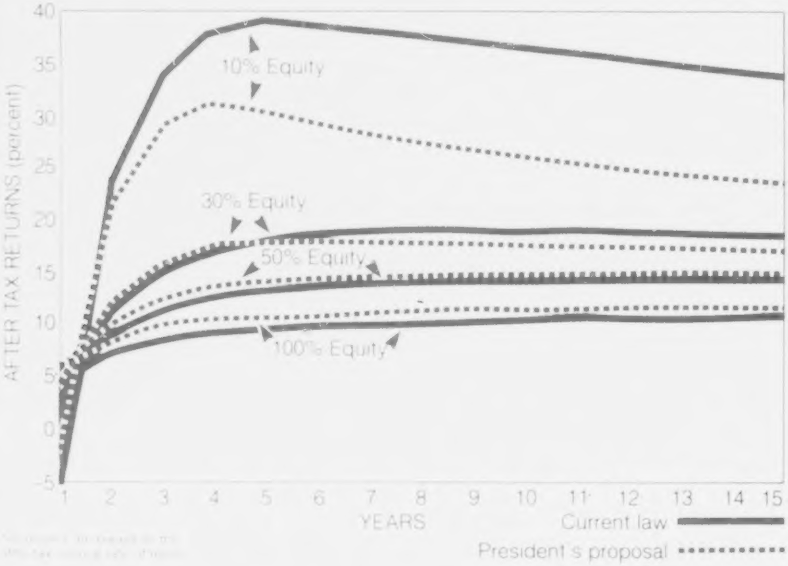
These measures reveal the important trend of the President's proposal. The payback period for residential construction will be lengthened significantly and the relative value of an apartment development will decrease during the early project life. Moreover, unless equity levels are greater than 50 percent, the relative investment return will decrease under the President's proposal.

Calculating the net effect of the President's proposal on investor property is more difficult. As the discussion above indicates, much depends on the way the property is financed, the level of equity contributed to the project and the expected holding period of the property. Because the project value under the President's proposal is dependent on both longer holding periods and the ultimate sale, the holding pattern of real estate will change dramatically. Property must be held longer because the depreciation schedules are greater in later years. The property must be sold because only after the sale will IRRs earned from the project equal IRRs earned under current law. However, the loss of cash flow during the holding period will tend to depress property values. If the full reduction in cash value were capitalized into the value of the property, the value of the building would decline about 10 percent, assuming a 15 percent discount rate.

Moreover, because the value of cash flow losses is recovered at the time of sale, owners may be motivated to sell buildings earlier, in order to "cash out" equity. Thus, while tax reform was designed, in part, to reduce the "churning" of property, the increased value in property equity may counter the advantages of property indexation. Therefore, it is not clear whether the

Figure 1

Comparison of after tax returns* (President's proposal v. current law)



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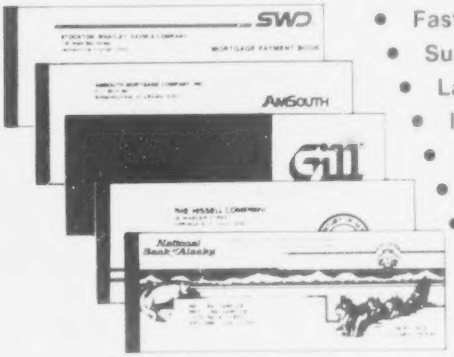

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provisions in the President's proposal will eliminate tax-motivated property sales.

The President's proposal will reduce the value of both owner-occupied and residential investment property, although much less so than in the original Treasury proposal. For homeowners, disposable income will increase and minimal declines in property values will occur. Moreover, the relative position of housing as an investment will remain high, further moderating potential declines in value.

An update

Recently a proposed tax bill passed the House of Representatives and another is expected to clear the Senate late in 1986. The tax treatment of owner occupants under the House bill and Treasury II is virtually identical with two exceptions. First, the House bill allows the deductibility of state and local taxes and the deduction of mortgage interest on second homes. Second, tax rates under the House bill fall far less than under Treasury II. Although the top tax rate drops to 38 percent, the rate brackets for most middle income Americans fall relatively little. In total, it appears that homeowners would fare better under the provisions of the House bill.

In general, the House bill treats investors less severely than Treasury II. First, CCRS in Treasury II would be replaced with indexed straight line depreciation over a 30-year period in the House bill. Second, the limitation on interest deductions proposed in Treasury II would be relaxed. Deductions for nonbusiness interest would be increased from $5,000 as proposed in Treasury II to $20,000 plus investment income.

From all appearances, it looks as though tax reform as applied to real estate is an attempt to turn the clock back and return to the tax laws that existed prior to 1981. The proposed changes in existing real estate tax law suggested in Treasury I are slowly but steadily being dropped or modified with each successive tax proposal. In all likelihood, if real estate tax reform occurs at all, the real estate industry will lose precisely what it gained as a result of the 1981 Economic Recovery Tax Act. Individual homeowners will remain relatively unaffected. ☐

MORTGAGE MARKET TRENDS

Lower interest rates, rising stock prices and lower world oil prices should provide the basis for 3 percent to 4 percent economic growth during 1986, a significant rise from the 2.4 percent rate reported for the fourth quarter. Interest rates should remain stable at current levels through mid-year.

Consumer spending can be expected to grow appreciably in the near-term. The increases of 834,000 in payroll employment over the November 1985 to January 1986 period, resulting in a drop in the civilian unemployment rate to 6.7 percent from the 7.0 percent recorded in October, adds significantly to purchasing power. Personal income shows signs of renewed strength, rising 1.4 percent in December. In addition, the bull market has resulted in a sharp increase in the value of stock and, in the process, consumer wealth. Finally, the Conference Board reports that consumer confidence remains high.

Business fixed investment increased markedly in the fourth quarter and will be strengthened in 1986 by today's relatively lower cost of capital. Inventory investment, with the exception of the automobile sector, should also increase. Both manufacturing and trade inventory to sales ratios have been edging down recently and are now lower than their recent trend levels.

The industrial sector shows signs of revival. Industrial production rose 0.3 percent in January, following increases of 0.7 percent and 0.6 percent, respectively in December and November. Capacity utilization has also shown an upward trend in recent months.

The continuing fall of the dollar should improve the net export sector in the near future. The dollar recently reached a seven-year low against the Japanese yen and has dropped substantially relative to the currencies of other major trading nations. The weaker dollar, together with the recent drop in oil prices, should stabilize the real volume of net exports in the first half. Moderate improvement in the nation's trade balance can be expected in the second half.

The rate of price increase should fall back into its moderate trend pattern in the very near future. After rising in the fourth quarter, largely due to increases in the price of food and fuel, both the producer price index and consumer price index appear headed toward their respective 1985 averages. Lower world oil prices have significantly improved the 1986 inflation outlook. During the course of the year, the inflation rate should be roughly equal to the 1985 record.

The Federal Reserve can be expected to maintain its current policy, shifting to a more accommodative stance if any fiscal restraints imposed by the Gramm-Rudman-Hollings Deficit Reduction Act warrant such a change. Thus resulting in stable rates at current levels through mid-year.

Low mortgage interest rates, a high level of housing affordability and steady economic growth should result in a continuation of the current strong housing market, especially in the first half.

Existing home sales in 1985 reached their highest level since 1979. New home sales also recorded impressive gains in recent months and stood at 721,000 in December at a seasonally adjusted annual rate. Even more impressive are the increases in both starts and permits, both of which stood at more than 1.8 million in December. Finally, the value of new construction put in place in 1985 was up 10 percent over the 1984 total.

Housing starts should total close to 1.8 million in 1986, with a particularly strong performance during the first half. Single-family originations should exceed $250 billion in dollar volume in 1986, after having recorded an estimated $230 billion in 1985.

Dr. Victor Cholewicki
Assistant Economist
February 18, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS Actual Total	1-4 Units	5+ Units	Seasonally Adjusted Annual Rate Total	1-4 Units	5+ Units	PERMITS 17,000 ISSUING PLACES Actual Total	1-4 Units	5+ Units	Seasonally Adjusted Annual Rate Total	1-4 Units	5+ Units
1985												
JUL	160	114	46	1,663	1,148	515	158	103	55	1,694	1,088	606
AUG	161	109	52	1,740	1,156	584	159	101	58	1,784	1,117	667
SEP	148	98	50	1,616	1,058	558	167	93	74	1,808	1,076	732
OCT	173	112	61	1,772	1,197	575	158	100	58	1,688	1,077	611
NOV	121	78	43	1,566	1,041	525	120	74	47	1,661	1,029	632
DEC$_P$	115	71	44	1,840	1,204	636	126	66	59	1,844	1,081	763
1983 TOTAL	1,703	1,181	522				1,605	1,035	570			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
12 MONTHS												
1985	1,733	1,164	569				1,739	1,083	656			
1984	1,750	1,206	544				1,682	1,065	617			
1983	1,703	1,181	522				1,605	1,035	570			
1982	1,062	743	320				1,001	635	366			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS Actual North East	Mid-West	South	West	Seasonally Adjusted Annual Rate North East	Mid-West	South	West	PERMITS 17,000 ISSUING PLACES Actual North East	Mid-West	South	West	Seasonally Adjusted Annual Rate North East	Mid-West	South	West
1985																
JUL	23	23	70	44	208	217	783	455	23	26	66	43	238	256	754	446
AUG	25	26	65	44	230	250	739	521	25	25	65	44	266	259	770	489
SEP	24	23	61	40	229	230	703	454	25	24	65	53	242	225	758	583
OCT	32	28	72	41	311	222	797	442	29	25	65	39	282	228	736	442
NOV	19	16	57	29	222	190	735	416	21	16	52	32	270	202	716	473
DEC$_P$	16	13	53	33	279	268	818	475	18	17	61	30	263	294	855	432
1983 TOTAL	168	218	935	382					164	188	863	390				
1984 TOTAL	204	243	866	436					201	212	812	457				
12 MONTHS																
1985	251	238	778	466					264	238	754	483				
1984	204	243	866	436					201	212	812	457				
1983	168	218	935	382					164	188	863	390				
1982	117	149	591	205					107	126	544	224				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
JUL	311	63	351	5.8	$198.8	$83.4	$29.5	$85.9	1,073	636	437	146	100	46
AUG	337	61	351	6.0	201.4	84.0	29.4	88.0	1,084	642	442	154	103	51
SEP	281	54	352	6.5	203.4	84.1	29.7	89.6	1,063	624	439	158	110	48
OCT	301	52	358	6.6	234.4	85.3	60.4	88.7	1,089	633	456	151	110	41
NOV	246	49	358	6.2	204.7	85.6	29.3	89.8	1,082	626	456	143	100	43
DEC$_P$	**221**	**47**	**356**	**5.8**	**212.5**	**85.8**	**31.4**	**95.3**	**1,082**	**620**	**462**	**159**	**111**	**48**
1983 TOTAL	2,719	623										1,390	1,016	374
1984 TOTAL	2,868	639										1,652	1,137	515
12 MONTHS														
1985	3,216	686										1,700	1,167	533
1984	2,868	639										1,652	1,137	515
1983	2,719	623										1,390	1,016	374
1982	1,990	412										1,006	712	293

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
FEB	$20,961	$4,273	$ 7,941	$ 7,351	$1,396	$12,944	$3,717	$5,618	$3,555	$ 54
MAR	25,406	4,333	10,681	8,350	2,042	16,517	4,037	7,887	4,502	91
APR	26,120	4,849	11,955	7,403	1,913	17,909	4,467	9,178	4,208	56
MAY	28,212	4,548	13,096	8,519	2,049	19,602	4,377	10,268	4,897	60
JUN	32,571	5,423	12,665	12,370	2,113	20,945	5,080	9,551	6,232	82
JUL$_P$	**30,932**	**6,028**	**11,709**	**11,051**	**2,144**	**20,959**	**5,655**	**9,093**	**6,110**	**101**
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
7 MONTHS										
1985	184,388	33,458	75,969	62,370	12,591	122,467	31,227	57,317	33,431	492
1984	175,871	33,330	77,815	55,992	8,734	123,189	31,187	59,205	32,322	475
1983	149,110	37,568	54,919	49,701	6,922	110,261	35,547	43,619	30,674	421
1982	67,238	14,857	21,931	25,749	4,701	45,997	13,406	18,001	14,302	288

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
FEB	$1,830	$378	$ 923	$396	$133	$6,187	$178	$1,400	$3,400	$1,209
MAR	2,020	170	1,162	511	177	6,869	126	1,632	3,337	1,774
APR	1,937	163	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN	2,329	228	1,417	590	94	9,297	115	1,697	5,548	1,937
JUL$_P$	**1,770**	**19**	**974**	**604**	**173**	**8,203**	**354**	**1,642**	**4,337**	**1,870**
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
7 MONTHS										
1985	13,108	1,028	7,628	3,413	1,039	48,813	1,203	11,024	25,526	11,060
1984	12,039	348	7,390	3,514	787	40,643	1,795	11,220	20,156	7,472
1983	8,225	425	4,469	2,792	539	30,624	1,596	6,831	16,235	5,962
1982	3,413	550	1,438	1,148	277	17,828	901	2,492	10,299	4,136

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg Bankers[9]	S&Ls	Banks[2]	Life Cos	Total	Mtg Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
FEB	$20,485	$3,695	$10,564	$3,624	$2,602	$ 92,165	$ 8,987	$50,899	$16,994	$15,285
MAR	28,222	3,404	14,217	7,831	2,770	98,340	8,921	53,175	21,748	14,496
APR	24,853	3,897	14,893	3,798	2,265	97,905	10,616	55,146	15,865	16,278
MAY	25,999	4,355	15,100	4,115	2,429	98,643	10,108	55,898	16,223	16,414
JUN	27,516	5,156	14,174	5,385	2,801	103,639	11,401	56,079	19,126	17,033
JUL$_P$	**26,393**	**4,288**	**14,594**	**4,928**	**2,583**	**95,189**	**10,167**	**49,838**	**17,882**	**17,302**
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
7 MONTHS										
1985	171,014	27,593	92,749	33,233	17,439					
1984	162,382	29,098	91,017	29,886	12,381					
1983	146,079	43,645	70,116	21,581	10,737					
1982	56,091	19,011	22,326	10,984	3,770					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
JUL	218	93	24	101	96	$6,558	11	$ 656	16	$1,104	69	$4,798
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP	201	82	26	93	130	8,545	47	2,771	20	1,318	63	4,456
OCT	205	84	24	97	122	8,308	34	2,041	16	1,120	72	5,147
NOV	173	78	27	68	128	8,488	47	2,795	25	1,693	56	4,000
DEC$_P$	**163**	**80**	**22**	**61**	**93**	**6,319**	**23**	**1,359**	**19**	**1,347**	**51**	**3,613**
1983 TOTAL	1,921	777	261	883	1,305	79,470	367	19,141	286	17,966	652	42,363
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
12 MONTHS												
1985	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984	1,879	477	197	1,205	1,344	86,774	200	10,644	198	12,728	946	63,402
1983	1,993	777	333	883	1,305	79,470	367	19,141	286	17,966	652	42,363
1982	1,034	400	163	471	570	29,074	103	4,893	93	5,428	374	18,753

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
JUL	$1,583	$ 1,918	$43,891	$ 1,527	$ 2,714	$ 3,258	$ 4,626	$ 4,385	$ 9,086	3,859
AUG	1,797	1,921	45,668	2,207	3,855	3,958	3,602	2,685	5,872	4,153
SEP	1,638	1,739	48,769	3,654	2,757	2,919	4,219	4,501	6,927	4,403
OCT	1,733	1,767	50,363	2,228	4,169	3,995	3,215	3,081	6,849	5,795
NOV	1,199	1,624	52,198	2,469	5,394	4,854	3,681	3,449	6,059	5,251
DECp	1,858	1,663	54,987	3,365	n.a.	n.a.	n.a.	n.a.	5,699	4,520
1983 TOTAL	18,607	17,553	—	13,340	30,921	32,846	22,952	21,376	70,280	50,496
1984 TOTAL	21,007	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
12 MONTHS										
1985	20,225	21,510	—	23,649	41,009*	43,337*	37,917*	35,119*	64,630	45,868
1984	21,006	16,721	—	13,546	26,968*	28,427*	17,747*	16,171*	36,101	27,857
1983	18,607	17,553	—	13,340	29,660*	31,143*	21,216*	20,256*	70,280	50,496
1982	22,106	15,113	—	13,969	27,287*	27,110*	19,755*	20,365*	38,865	16,012

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[2]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1985								
SEP	12.04%	12.02%	12.03%	11.17%	11.20%	10.54%	11.775%	13.21%
OCT	11.87	11.86	11.88	11.09	11.32	10.50	11.575	13.03
NOV	11.28	11.56	11.58	11.01	11.26	10.26	11.160	12.38
DEC	10.70	11.03	11.03	10.94	11.12	9.94	10.425	12.06
1986								
JANp	n.a.	n.a.	n.a.	10.89	10.81	10.00	10.375	12.00

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
AUG	11.39%	11.38%	11.42%	11.77%	10.33%	7.32%	7.72%
SEP	11.41	11.43	11.47	11.87	10.37	7.27	7.83
OCT	11.24	11.28	11.34	11.82	10.24	7.33	7.80
NOV	10.96	10.95	11.01	11.38	9.78	7.30	7.77
DEC	n.a.	n.a.	n.a.	10.91	9.26	7.14	7.75
1986							
JANp	n.a.	n.a.	n.a.	10.74	9.19	7.16	7.71

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
JUL	35	95	99	96
AUG	22	106	105	109
SEP	17	104	106	110
OCT	49	100	104	110
NOV	(10)	118	117	123
DECp	(21)	n.a.	n.a.	n.a.

n.a.—Not available. p—Preliminary.

[1] From the National Association of Realtors "Existing Home Sales" series.

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year to date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

*—11 Month Totals.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	**5,250**	**4,090**	**1,280**	**690**	**2,120**	**80**	**0**	**80**	**1,080**	**4,880**	**3,860**	**70**	**770**
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	**5,480**	**4,090**	**430**	**960**	**4,850**	**3,910**	**80**	**860**	**7,850**	**100**	**750**	**7,810**	**260**	**1,170**
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

		1-4 Units				5+ Units			
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	**6,840**	**6,090**	**1,500**	**980**	**3,610**	**170**	**0**	**170**	**580**

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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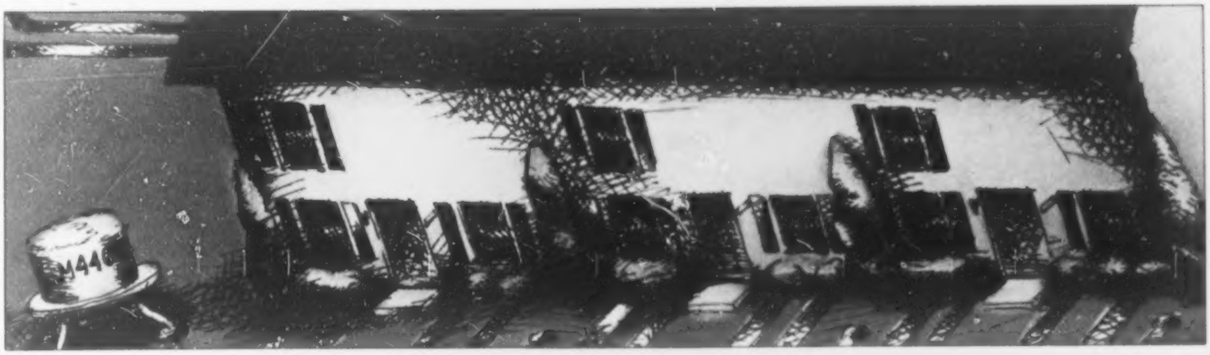

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MORTGAGE MARKET TRENDS

Homebuilders and mortgage lenders are in a state of euphoria and understandably so. Last year, sales of new and existing single-family houses rose for the third consecutive year to the highest levels since the late 1970s, while originations of single-family mortgage loans increased by an estimated 22 percent above the 1984 level to a record $250 billion. Adding to this euphoric state is a perception that these good times will continue to roll. Since the fall of 1985, long-term interest rates have fallen by 250 basis points, allowing rates on 30-year, fixed-rate mortgages to drop to their lowest levels in eight years and raising expectations that 1986 will be another banner year for housing.

In all likelihood, these expectations should turn out to be well-founded, for the economic conditions that fostered today's financial market environment will probably prevail throughout a good portion of the year. First, the strong employment gains recorded throughout this recovery, combined with the stimulative effects of the drop in interest rates, the stock market rally, the drop in world oil prices and the depreciation in the foreign exchange value of the dollar should keep the recovery on an upward track.

At the same time, however, there seems to be little danger that the economy will become overheated any time soon. Despite the drop in the value of the dollar, the trade deficit will not act as a source of stimulus to domestic production until later this year.

Also, the low personal savings rate, coupled with high consumer debt ratios appears to be restraining consumer spending. During the first two months of 1986, retail sales (excluding autos) hardly exceeded last year's fourth quarter average despite the increase in consumer wealth. Further, stimulus emanating from business investment spending should be fairly limited, for whatever upward revisions in capital spending plans are generated by lower interest rates may be largely offset by sharp capital outlay cutbacks in the energy industries.

On balance then, we anticipate another year of moderate, yet healthy growth. During the four quarters of 1986, we anticipate that real GNP growth will come close to 3½ percent, with perhaps a modest acceleration taking place in the second half as consumer spending begins to respond to lower interest rates and rising stock prices and as export growth starts to benefit from the cheaper dollar.

In this scenario, the conditions required to keep interest rates near current levels and to sustain the housing expansion should be preserved. Little, if any, upward pressure on interest rates should materialize from demand pressures or supply bottlenecks. At the same time, inflation can be expected to remain subdued this year, with the softer oil prices offsetting whatever inflationary effects may arise from the decline in the value of the dollar. Thus, a rise in interest rates does not appear to be in the cards for at least the next six months.

Further, the recent drop in the discount rate suggests that monetary policy will remain accommodative at least during the near to medium term. Apparently, the current economic data are soft enough, that when combined with the recent slowdown in money supply growth, growing concerns regarding the ability of oil-producing, less-developed countries to service their massive debts and what appears to be stronger prospects for fiscal restraint, the Fed currently feels comfortable in erring on the side of ease rather than restrictiveness. Therefore, the chances of seeing an escalation in interest rates arising from a leaning on the monetary brakes seems remote at this juncture.

In short, the anticipated economic and policy environment should allow interest rates to average near current levels through the year. During the near-term, an additional decline—approximately 25 basis points—across the spectrum of maturities is a distinct possibility. As we approach summer, however, a modest acceleration in the pace of economic activity may lift rates back up to current levels or slightly higher. Thus, we expect rates on 30-year, fixed-rate mortgages to range between 9½ to 10½ percent, with rates on one-year adjustable rate mortgages hovering between 8 to 9 percent.

Obviously, this makes for a bullish housing outlook. Housing starts should average near 2 million units during the first half of the year and roughly 1.85 million units for 1986 as a whole. Sales of new and existing single-family houses will probably exceed four million units.

This sales volume, combined with especially strong refinancing activity during the first half of the year, should push single-family loan origination volume to about $300 billion or about 25 percent above the 1985 estimate. The composition of this origination activity will be largely fixed-rate mortgages and FHA/VA loans will command an above average share of the total market. Given the expected composition of lending activity, mortgage bankers should capture at least 30 percent of the single-family market or $90 billion in origination volume. Finally, with an abundant supply of fixed-rate product, secondary market activity this year will be extremely strong, with issues of mortgage-backed securities rising by at least 15 to 20 percent above the $107 billion level recorded in 1985.

Of course, good times cannot last forever and developments could arise that would quickly sour today's sweet environment. For instance, one cannot rule out the possibility that the Supreme Court will uphold the lower court's ruling that the Gramm-Rudman-Hollings (GRH) sequestration procedures are unconstitutional and that the loss of that disciplining factor could lead to a breakdown in efforts to produce a credible budget deficit reduction package. Under those circumstances, a much stronger and potentially inflationary acceleration in growth could occur during the second half, as the intended policy mix of monetary accommodation and fiscal restraint never materializes.

Fortunately, while we do not feel the GRH budget deficit targets will be met, we do believe that the prospects of achieving more gradual but substantial deficit reductions are quite good and that we can avoid being knocked off the desired path of moderate, noninflationary growth. Indeed, the durability of this housing expansion will depend greatly on whether our sanguine fiscal outlook becomes a reality.

Edison R. Zayas
Senior Economist
March 14, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
AUG	161	109	52	1,740	1,156	584	159	101	58	1,784	1,117	667
SEP	148	98	50	1,616	1,058	558	167	93	74	1,808	1,076	732
OCT	173	112	61	1,772	1,197	575	158	100	58	1,688	1,077	611
NOV	125	80	45	1,566	1,041	525	120	74	47	1,661	1,029	632
DEC	115	71	44	1,840	1,204	636	128	68	60	1,873	1,101	763
1986												
JAN$_p$	119	80	39	2,088	1,465	623	116	73	43	1,870	1,208	662
1985 TOTAL	1,736	1,165	571				1,741	1,085	656			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
1 MONTH												
1986	119	80	39				116	73	43			
1985	105	66	39				104	64	40			
1984	109	75	34				111	67	44			
1983	93	64	29				85	56	29			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
AUG	25	26	65	44	232	245	751	509	25	25	65	44	266	259	770	489
SEP	24	23	61	40	234	232	725	462	25	24	65	53	242	225	758	583
OCT	32	28	72	41	299	226	801	458	29	25	65	39	282	228	736	442
NOV	20	17	57	29	235	210	767	442	21	16	52	32	270	202	716	473
DEC	17	13	53	32	275	262	818	449	19	17	62	30	276	295	862	440
1986																
JAN$_p$	14	10	66	29	352	320	959	457	13	12	57	34	283	331	759	497
1985 TOTAL	251	240	779	467					265	238	755	482				
1984 TOTAL	204	243	866	436					201	212	812	457				
1 MONTH																
1986	14	10	66	29					13	12	57	34				
1985	10	8	56	32					13	8	53	31				
1984	7	8	63	33					7	9	61	32				
1983	6	6	52	21					5	6	63	18				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
AUG	337	61	351	5.9	201.4	84.0	29.4	88.0	1,084	642	442	154	103	51
SEP	281	54	352	6.4	203.4	84.1	29.7	89.6	1,063	624	439	158	110	48
OCT	301	52	358	6.5	234.4	85.3	30.4	88.7	1,089	633	456	151	110	41
NOV	246	50	357	6.1	204.9	86.0	29.3	89.6	1,087	627	460	143	100	43
DEC	221	46	356	5.8	211.0	86.5	30.0	94.5	1,089	620	471	162	113	49
1986														
JAN$_P$	215	57	356	5.9	213.1	88.8	30.5	93.8	1,101	633	468	123	81	42
1985 TOTAL	3,216	686										1,700	1,167	533
1984 TOTAL	2,868	639										1,652	1,137	515
1 MONTH														
1986	215	57										123	81	42
1985	190	48										117	83	34
1984	178	52										112	76	36
1983	155	44										81	60	21

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
MAR	25,417	4,344	10,681	8,350	2,042	16,463	3,983	7,887	4,502	91
APR	26,291	5,020	11,955	7,403	1,913	18,069	4,627	9,178	4,208	56
MAY	28,564	4,900	13,096	8,519	2,049	19,954	4,729	10,268	4,897	60
JUN	32,571	5,869	12,665	12,370	2,113	21,151	5,286	9,551	6,232	82
JUL	30,932	6,503	11,709	11,051	2,144	21,273	5,969	9,093	6,110	101
AUG$_P$	34,953	7,817	13,324	11,832	1,980	25,544	7,054	10,996	7,390	104
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
8 MONTHS										
1985	221,242	42,730	89,760	74,201	14,551	148,989	39,259	68,313	40,821	596
1984	198,513	36,600	90,347	61,106	10,460	140,133	34,257	68,751	33,586	539
1983	178,227	40,827	66,210	52,549	18,641	124,007	38,354	52,816	32,359	478
1982	77,666	17,441	25,532	29,446	5,247	53,530	15,793	20,910	16,494	333

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
MAR	2,020	170	1,162	511	177	6,934	91	1,632	3,337	1,774
APR	1,948	174	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN	2,519	418	1,417	590	94	9,347	165	1,697	5,548	1,937
JUL	1,770	53	974	604	173	8,203	481	1,642	4,337	1,870
AUG$_p$	**2,200**	**238**	**1,085**	**665**	**212**	**7,209**	**525**	**1,243**	**3,777**	**1,664**
el4										
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
8 MONTHS										
1985	13,108	1,501	8,713	4,077	1,251	9,297	1,970	12,734	29,303	12,704
1984	13,634	348	8,611	3,864	811	8,203	1,995	12,985	23,656	9,110
1983	9,269	471	5,209	2,808	781	35,111	2,002	8,185	17,382	7,542
1982	3,962	584	1,718	1,370	290	20,174	1,064	2,904	11,582	4,624

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
MAR	28,291	3,473	14,217	7,831	2,770	98,737	9,318	53,175	21,748	14,496
APR	25,008	4,052	14,893	3,798	2,265	98,391	11,102	55,146	15,865	16,278
MAY	26,151	4,507	15,100	4,115	2,429	99,080	10,545	55,898	16,223	16,414
JUN	28,091	5,731	14,174	5,385	2,801	105,378	13,116	56,079	19,150	17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,731	14,684	49,838	17,907	17,302
AUG$_p$	**32,137**	**6,601**	**16,969**	**5,435**	**3,132**	**104,751**	**15,227**	**50,198**	**20,667**	**18,659**
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
8 MONTHS										
1985	205,501	36,543	109,718	38,669	20,571					
1984	182,028	31,837	103,333	33,602	13,256					
1983	163,862	43,819	82,784	24,877	12,382					
1982	64,895	21,961	26,173	12,561	4,200					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt	Units	Amt	Units	Amt	Units	Amt.
1985												
AUG	216	88	25	103	114	7,646	28	1,644	19	1,275	67	4,727
SEP	201	82	26	93	130	8,545	47	2,771	20	1,318	63	4,456
OCT	205	84	24	97	122	8,308	34	2,041	16	1,120	72	5,147
NOV	173	78	27	68	128	8,488	47	2,795	25	1,693	56	4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN$_p$	**205**	**130**	**24**	**51**	**110**	**7,298**	**45**	**2,659**	**19**	**1,304**	**46**	**3,335**
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
1 MONTH												
1986	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
1985	107	23	14	70	93	5,973	20	1,125	11	723	62	4,125
1984	121	26	19	76	109	7,017	14	753	24	1,544	71	4,720
1983	137	68	30	39	54	3,201	14	637	10	630	30	1,934

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
AUG	1,797	1,921	45,668	2,207	3,855	3,958	3,602	2,685	5,872	4,153
SEP	1,638	1,739	48,769	3,654	2,757	2,919	4,219	4,501	6,927	4,403
OCT	1,733	1,767	50,363	2,228	4,169	3,995	3,215	3,081	6,849	5,795
NOV	1,199	1,624	52,198	2,469	5,394	4,854	3,681	3,449	6,059	5,251
DEC	1,858	1,663	54,987	3,365	3,076	3,425	6,095	6,335	5,699	4,520
1986										
JANp	**1,315**	**1,188**	**58,391**	**3,964**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**10,103**	**5,298**
1984 TOTAL	21,007	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
1983 TOTAL	18,607	17,553	—	13,340	30,921	32,846	22,952	21,376	70,280	50,496
1 MONTH										
1986	1,315	1,188	—	3,964	n.a.	n.a.	n.a.	n.a.	10,103	5,298
1985	1,300	1,943	—	913	4,142	4,264	2,197	1,984	4,573	2,654
1984	1,772	1,285	—	251	1,293	1,470	1,419	978	2,500	2,718
1983	2,006	2,045	—	1,082	2,364	2,059	1,479	1,641	4,593	2,657

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1985								
SEP	12.04%	12.02%	12.03%	11.17%	11.20%	10.54%	11.775%	13.21%
OCT	11.87	11.86	11.88	11.09	11.32	10.50	11.575	13.03
NOV	11.28	11.56	11.58	11.01	11.26	10.26	11.160	12.38
DEC	10.70	11.03	11.03	10.94	11.12	9.94	10.425	12.06
1986								
JAN	10.78	10.82	10.93	10.87	10.83	10.00	10.375	12.00
FEBp	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**n.a.**	**9.89**	**10.069**	**11.63**

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
SEP	11.41%	11.43%	11.47%	11.87%	10.37%	7.27%	7.83%
OCT	11.24	11.28	11.34	11.82	10.24	7.33	7.80
NOV	10.75	10.95	11.01	11.38	9.78	7.30	7.77
DEC	10.02	n.a.	n.a.	10.91	9.26	7.14	7.75
1986							
JAN	9.99	10.18	10.22	10.74	9.19	7.16	7.71
FEBp	9.75	9.90	9.95	10.21	8.70	7.11	7.63

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt	FNMA Minus 10-Yr. Govt	FHLMC Minus 10-Yr. Govt
1985				
SEP	17	104	106	110
OCT	49	100	104	110
NOV	(10)	97	117	123
DEC	(21)	76	n.a.	n.a.
1986				
JAN	4	80	99	103
FEBp	**n.a.**	**105**	**120**	**125**

n.a.—Not available. p—Preliminary.

[1] From the National Association of Realtors "Existing Home Sales" series.

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year to date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

* = 11 Month Totals

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]	Total[2]	1-4 Units	5+ Units	Non-res.[3]
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,880	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-res.[3]	Total	1-4 Units	5+ Units	Non-res.[3]	1-4 Units	5+ Units	Non-res.[3]	1-4 Units	5+ Units	Non-res.[3]
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	260	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH		1-4 Units				5+ Units			
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	580

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,330	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	350	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes [1] All dollar amounts are in millions

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts

[3] Series labeled non-residential are also inclusive of farm data

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100

[5] Year-to-date seasonally adjusted series not calculated

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MORTGAGE BANKING

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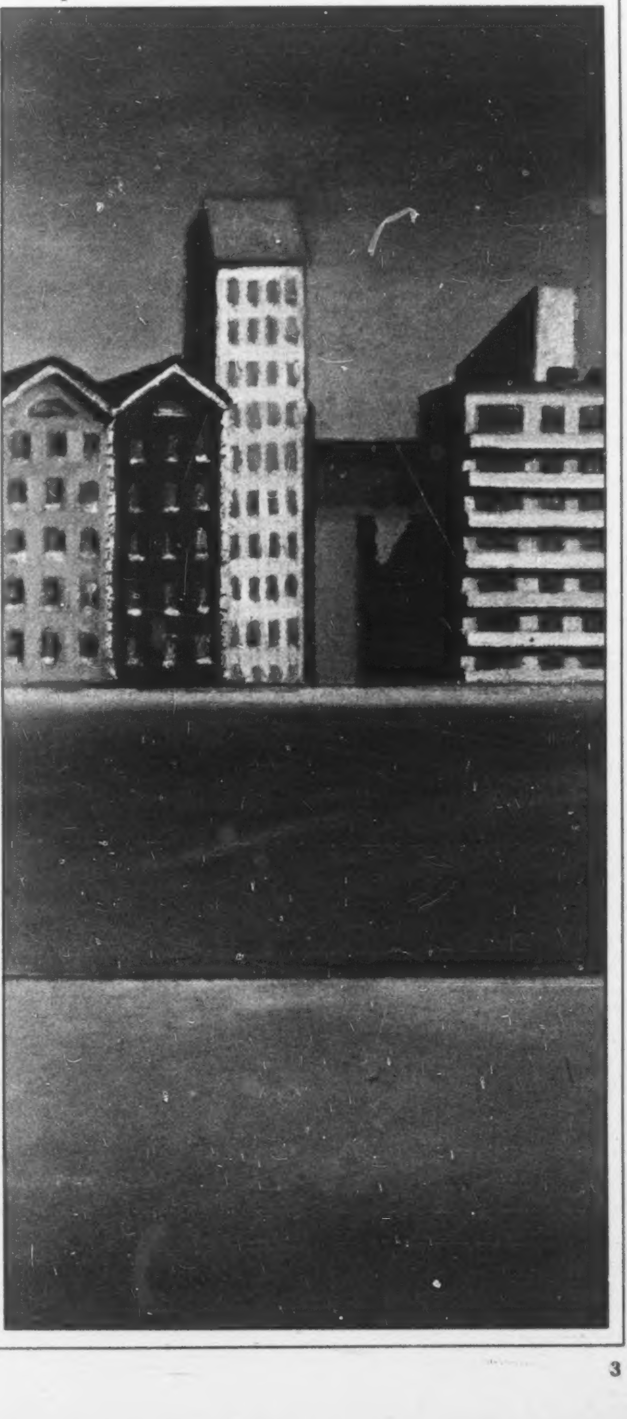
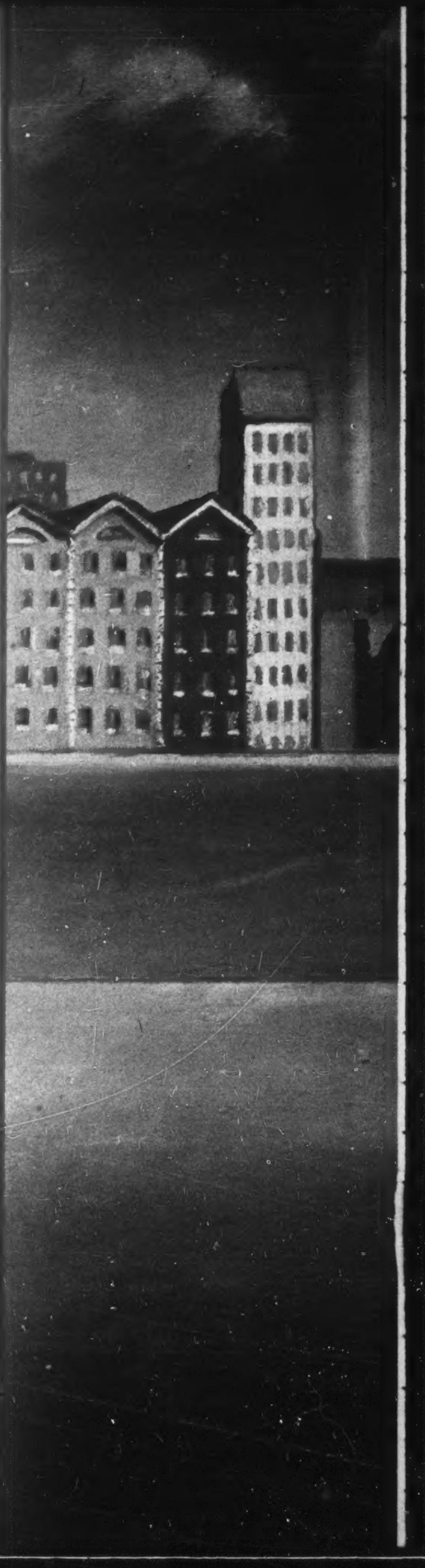


FREDDIE MAC'S MULTIFAMILY SHOPPING SPREE

In 1985, the Federal Home Loan Mortgage Corporation (Freddie Mac) purchased conventional multifamily mortgages in record volume under its multifamily programs. At year-end, Freddie Mac had committed to purchase more than $2 billion of multifamily mortgages, representing more than 2,000 mortgages approved for purchase. This total was double the amount projected for the year and, when compared with the two previous years, represented an approximate increase of 300 percent during 1984 and 600 percent during 1983.

Freddie Mac purchased these mortgages under two programs—plan A and plan B. The more popular of the two, plan B, accepts mortgages that are typically amortized over a 30-year period but have stated maturities of 10- to 15-years with a balloon payment at maturity. The borrower cannot prepay, in part or in whole, a plan B mortgage for a minimum period of 54 months after delivery to Freddie Mac. However, the mortgage may be assumed by a qualified borrower subject to Freddie Mac's approval. The plan A program is basically for purchases of 10- to 30-year, nonassumable mortgages, most of which are fully amortizing. (A Freddie Mac multifamily program summary is provided in this article for further information about these plans.)

Charles Goetze



With the tremendous amount of volume generated by these purchase programs, Freddie Mac needed to streamline its multifamily processing in order to handle the volume and still continue to purchase investment quality mortgages while keeping the approval turnaround time down to an acceptable level. With this in mind, Freddie Mac has developed new forms to reduce the processing time and has begun developing a new automated multifamily underwriting system.

Development of two new forms

To streamline multifamily mortgage processing, two new forms have been developed—the apartment analysis and rental overview form and the multifamily property underwriting analysis form. Both forms are intended to be completed by seller/servicers.

The apartment analysis and rental overview form is a generic inspection form that can be used by Freddie Mac, the seller or an independent third party inspector. The form is intended to provide the reviewer an independent verification of certain physical and economic characteristics common to multifamily properties. Specifically, the form will provide:

- A general overview of the marketability and appeal of the area and neighborhood.
- Current vacancy information for both the neighborhood and the subject property.
- A comparison of the subject property and competing properties in the area.
- A review of the appraiser's rental comparables used in the appraisal report.

Freddie Mac's regional personnel will now have the option of accepting the inspection form that is completed by a selected seller, eliminating the need for a Freddie Mac inspection. This option should speedup processing time by an average of eight days. Prior to the development of this form, Freddie Mac or a third party inspected every property prior to the approval of the mortgage for purchase.

Charles Goetze is director of multifamily/project loans for Freddie Mac. Prior to joining Freddie Mac, Goetze was assistant vice president and manager-income property lending for Talman Home Investment, a subsidiary of Talman Home Federal Savings and Loan Association of Illinois.

The multifamily property underwriting analysis form is—as its name implies—a form to be used in underwriting multifamily mortgages. The form provides a working document for the seller's underwriting analysis of the subject mortgage. The corporation intends to have all sellers submit this form as part of each mortgage file. This will reduce the time required by a Freddie Mac underwriter to compile the figures required to underwrite a multifamily mortgage.

The form will standardize and consolidate the underwriting process. Each seller already performs an underwriting analysis prior to submitting the loan package to Freddie Mac. Unfortunately, the sellers often present their figures in different formats. The new form should promote consistency and assist the underwriters to complete their analysis in a more timely manner.

These two multifamily forms are available through any of Freddie Mac's regional offices. Interested sellers are encouraged to contact a multifamily specialist in these offices to discuss the new forms and to review the programs. Instructions for completing the forms will be provided with the package of materials.

A new automated multifamily underwriting system

In addition to developing new forms, Freddie Mac is working to streamline its processing in other ways. A new automated multifamily underwriting system (AMUS) is currently under development. This new system will utilize the information supplied by the seller on the new multifamily property underwriting analysis form to assist the underwriter in the actual "number crunching." The system will be PC-driven, using d-Base software and eventually will be integrated into Freddie Mac's Mortgage Information Direct Access System (MIDAS) mainframe system. The system is designed both to assist the underwriter in analysis of the mortgage and generate numerous statistical reports and complete Freddie Mac forms. This automated system should free up staff from many mathematical calculations and allow them to concentrate on analysis and underwriting of mortgages.

AMUS is currently being tested and it is anticipated that it will be operational by mid-1986. Future applications of this new system will include a Mortgage Information Direct Access System Network (MIDANET)-type enhancement, utilizing a seller's own system to transmit data prior to submittal of a mortgage package to Freddie Mac.

Plan B enhancements under review

In response to comments from seller/servicers, Freddie Mac is developing enhancements to the plan B program. These enhancements include: pricing differentials for 10- and 15-year balloon mortgages; a potential 7-year balloon mortgage under the plan B program (with separate pricing); ex-

CHART 1

Freddie Mac Cash Programs Only

Commitment activity 1983 through 1985
Loan Approvals

	1983	1984	1985
Dollar volume	$372.9 mil	$487.6 mil	$2.271 bil
Number of loans	375	436	1,926

Regional Comparison 1984 to 1985

	1984		1985	
	Loan #	Amount	Loan #	Amount
NE	196	$250.7 mil	715	$1.022 bil
SE	71	87.1 mil	261	322.2 mil
NC	89	89.6 mil	320	356.5 mil
SW	44	42.7 mil	196	210.9 mil
W	36	17.5 mil	434	359.1 mil

tended option periods under prior approval; rate lock optional commitments and shorter mandatory delivery contracts (with separate pricing).

In reviewing the proposal to offer separate net yield requirements, Freddie Mac expects the yield on a 10-year plan B to be about 20 basis points less than the 15-year plan B. A 7-year balloon mortgage may be added to the plan B program. The pricing differential has not yet been determined.

Under the plan B prior approval program, the maximum optional commitment period is 60 days, but Freddie Mac is considering adding optional periods extending from 2 to 12 months. A seller would be required to designate the delivery period and the type of commitment when submitting the loan for prior approval so that the Freddie Mac underwriter will know the appropriate interest rate to use. Yields and fees will be determined based on the optional period selected.

A rate lock optional commitment, under review, would lock the seller into a maximum yield, but would not be tied to a specific mortgage as is the case under the prior approval program. These rate lock optional commitments would be offered for commitments periods of 2 to 12 months to lock-in a rate before submitting an application. It would be useful for rate projections on new construction projects, rehabilitation projects or pipeline commitments.

Also under consideration is a 10-day mandatory delivery contract in addition to the present 30-day mandatory delivery contract. The 10-day mandatory delivery contract would provide a reduction in the required net yield relative to the 30-day mandatory commitment, with the differential varying according to market conditions.

As Freddie Mac begins to implement any of these proposed enhancements, all eligible seller/servicers will be notified promptly so that they may take full advantage of the programs.

Interest in these multifamily programs is on the rise and a total anticipated volume of $3 billion or more is expected in 1986. With this increased volume will come more pass-through securities backed entirely by newly originated multifamily mortgages. Freddie Mac sold $800 million of multifamily mortgage participation certificates (PCs) in the summer of 1985. (See the article in *Mortgage Banking*, February 1986, "Multifamily Securities—An Untapped Market" and the article in *Secondary Mortgages Market*, Winter 1985-86, "High Rising Securitizing.") The creation of the multifamily PC should improve the liquidity of multifamily mortgages and thereby increase the flow of funds to that sector.

As purchase volume increases, Freddie Mac will continue to update its processing system and develop new procedures that meet sellers' needs. The corporation was the first to respond to the need for a secondary market program for conventional multifamily loans—back in 1972—and continues to lead the mortgage industry with aggressive, creative solutions to multifamily financing programs for the 1980s and beyond. ☐

Our experts are at your beck and call.

Through our system of regional offices, Freddie Mac makes it easy to do business locally. And, because our representatives live in your area, they're never far away when you call.

Freddie Mac's five regional offices are listed below. The gnomes of Freddie Mac are waiting to hear from you.

Northeast Region
2001 Jefferson Davis Highway
Suite 901, P.O. Box 2408
Arlington, Virginia 22202-1008
(703) 685-1455

North Central Region
333 West Wacker Drive, Suite 3100
Chicago, Illinois 60606-1287
(312) 407-7474

Southeast Region
2839 Paces Ferry Road, NW
Suite 700, P.O. Box 723788
Atlanta, Georgia 30339-3718
(404) 438-3800

Southwest Region
12222 Merit Drive, Suite 700
Dallas, Texas 75251
(214) 702-2000

Western Region
15303 Ventura Boulevard, Suite 500
Sherman Oaks, California 91403
(818) 905-3400

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Freddie Mac

[illegible]

MORTGAGE MARKET TRENDS

The swelling volume of loan applications in recent months has strained the industry's processing capabilities to the point where many mortgage lenders are currently faced with the decision whether or not to add personnel permanently or temporarily to their production capacity. Obviously, such a decision depends on one's judgment as to whether or not the recent volume ot originations is merely a flash in the pan or representative of what we can expect during the foreseeable future.

From where MBA stands, there are good reasons to believe that recent mortgage market trends are fairly indicative of things to come. As we have stated in recent columns, our crystal ball reveals a highly favorable interest rate environment throughout the year. Thus far, the pace of economic growth in 1986 has been restrained by sluggish consumer spending, lethargic business investment and accordingly, weak industrial production. Despite the sharp drop in the foreign exchange value of the dollar since last summer, the manufacturing sector as a whole has yet to reap the benefits of its improved price competitiveness abroad. Also, falling oil prices have hampered the ability of oil-producing, less-developed countries to service their enormous debt burdens, thereby threatening our financial system with the renewed risk of massive loan defaults. Thus, in light of these circumstances, it seems reasonable to assume that the Federal Reserve Board (Fed) will continue to pursue an accommodative monetary policy, keeping interest rates near or slightly below current levels through the first half of the year.

Further, we remain fairly optimistic that the combination of the spirit of the Gramm-Rudman Act and grass roots pressure to restore fiscal discipline to the federal budget, will produce the long overdue, albeit gradual reduction, in the budget deficit. Therefore, with the improved prospects for fiscal restraint, interest rates may not come under much upward pressure even though the rate of economic growth turns up in the second half.

As a result, the current wave of refinancing activity is likely to last well into the summer months, for there are still thousands of homeowners with above-market mortgages that have yet to jump off the fence. For example, there are currently 2 million Federal Housing Administration/Veterans Administration (FHA/VA) loans outstanding with interest rates above 12 percent. Clearly, the well of refinancing business runs deep in the anticipated interest rate environment.

Moreover, origination activity related to housing sales is likely to pickup throughout the year. For example, housing purchases can be expected to improve in the late spring and early summer months when housing purchases are typically the strongest. In addition, sales are likely to increase as economic growth in the second half of the year begins to accelerate. Affordable interest rates, low oil prices, the wealth effects of the stock market rally earlier in the year and a gradually rebounding trade sector should improve employment and real income growth, in turn helping to lift housing sales activity off the plateau it has rested upon since the fourth quarter of 1985. Therefore, even if refinancing activity begins to slacken later in the year, a faster pace of economic growth in latter half of the year may very well generate a boost in home sales, subsequently maintaining a high level of loan applications for the year as a whole.

While one cannot rule out an abrupt rise in interest rates due to a breakdown in the federal budget talks, political pressures to produce a credible deficit reduction package will hopefully avoid such a development.

In sum, the current volume of business is not likely to be a temporary phenomenon. On the contrary, there is every reason to believe that 1986 residential loan origination volume will be the strongest on record, with mortgage bankers capturing at least 30 percent of a forecasted total of $300 billion.

Edison R. Zayas
Senior Economist
April 14, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
OCT	173	112	61	1,772	1,197	575	158	100	58	1,688	1,077	611
NOV	125	80	45	1,566	1,041	525	120	74	47	1,661	1,029	632
DEC	115	71	44	1,882	1,181	701	128	68	60	1,873	1,101	763
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,907	1,223	684
FEB	107	71	36	1,997	1,319	678	109	68	41	1,803	1,147	656
MAR	150	104	46	1,949	1,300	649	151	98	53	1,846	1,152	694
1985 TOTAL	1,736	1,165	571				1,741	1,085	656			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
3 MONTHS												
1986	373	254	119				379	240	139			
1985	344	235	109				349	223	126			
1984	372	259	113				382	244	138			
1983	323	225	99				313	203	109			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
OCT	32	28	72	41	299	226	801	458	29	25	65	39	282	228	736	442
NOV	20	17	57	30	235	210	767	442	21	16	52	32	270	202	716	473
DEC	17	13	57	34	283	261	870	468	19	17	62	30	276	295	862	440
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	304	329	770	504
FEB	13	11	51	33	411	364	744	478	12	12	53	32	301	306	727	469
MAR	21	20	70	40	332	335	772	510	21	20	64	46	282	276	708	580
1985 TOTAL	251	240	779	467					265	238	755	482				
1984 TOTAL	204	243	866	436					201	212	812	457				
3 MONTHS																
1986	48	41	183	102					47	44	175	112				
1985	34	32	180	99					44	32	171	103				
1984	27	35	212	98					31	35	206	110				
1983	25	27	201	71					25	26	191	71				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
SEP	281	54	352	6.4	203.4	84.1	29.7	89.6	1,063	624	439	158	110	48
OCT	301	52	358	6.5	204.2	85.3	30.3	88.6	1,087	633	456	151	110	41
NOV	246	51	357	6.1	205.1	86.0	29.2	89.9	1,087	627	460	143	100	43
DEC	221	47	352	5.8	210.4	86.6	29.9	93.9	1,088	618	471	162	113	49
1986														
JAN	213	54	353	6.2	212.1	89.2	29.9	93.0	1,097	629	467	122	81	41
FEBp	217	55	347	6.4	217.7	81.3	31.0	95.4	1,116	642	473	118	76	42
1985 TOTAL	3,216	686										1,700	1,167	533
1984 TOTAL	2,868	639										1,652	1,137	515
2 MONTHS														
1986	430	109										240	157	83
1985	386	98										240	163	77
1984	380	110										221	153	68
1983	318	90										159	113	46

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
APR	26,291	5,020	11,955	7,403	1,913	18,069	4,627	9,178	4,208	56
MAY	28,564	4,900	13,096	8,519	2,049	19,954	4,729	10,268	4,897	60
JUN	32,571	5,869	12,665	12,370	2,113	21,151	5,286	9,551	6,232	82
JUL	30,932	6,503	11,709	11,051	2,144	21,273	5,969	9,093	6,110	101
AUG	34,928	7,792	13,324	11,832	1,980	25,518	7,028	10,996	7,390	104
SEPp	32,855	7,193	13,316	7,197	5,149	23,850	6,709	10,483	6,541	117
1984 TOTAL	297,406	53,160	129,482	97,776	16,988	196,139	44,500	96,187	54,626	826
1983 TOTAL	276,371	65,050	103,882	91,500	15,939	193,535	55,680	81,524	55,605	726
9 MONTHS										
1985	221,242	42,730	89,760	74,201	14,551	148,989	45,942	78,796	47,363	713
1984	222,682	39,605	100,001	71,738	11,338	140,133	37,024	75,640	40,964	596
1983	199,416	45,560	76,541	67,099	10,216	145,776	42,649	60,943	41,657	527
1982	88,890	19,932	29,390	33,847	5,721	61,676	18,158	24,040	19,100	378

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
APR	1,948	174	1,223	406	145	6,274	219	1,554	2,789	1,712
MAY	1,992	34	1,238	505	215	6,618	137	1,590	3,117	1,774
JUN	2,519	418	1,417	590	94	9,347	165	1,697	5,548	1,937
JUL	1,804	53	974	604	173	8,330	481	1,642	4,337	1,870
AUG	2,201	239	1,085	665	212	7,209	525	1,243	3,777	1,664
SEP$_p$	2,202	287	1,099	656	160	8,907	197	1,734	5,149	1,827
el4										
1984 TOTAL	22,125	1,980	13,160	5,519	1,466	79,142	6,680	20,135	37,631	14,696
1983 TOTAL	19,443	3,840	8,521	5,485	1,597	63,393	5,530	13,837	30,410	13,616
9 MONTHS										
1985	17,746	1,789	9,812	4,734	1,411	65,619	2,167	14,468	34,453	14,531
1984	15,131	399	9,694	4,203	835	53,327	2,182	14,667	26,571	9,907
1983	11,207	540	5,983	3,767	917	42,433	2,371	9,615	21,675	8,772
1982	4,535	605	2,013	1,605	312	22,679	1,169	3,337	13,142	5,031

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
APR	25,008	4,052	14,893	3,798	2,265	98,391	11,102	55,146	15,865	16,278
MAY	26,151	4,507	15,100	4,115	2,429	99,080	10,545	55,898	16,223	16,414
JUN	28,091	5,731	14,174	5,385	2,801	105,354	13,116	56,079	19,126	17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,706	14,684	49,838	17,882	17,302
AUG$_p$	32,123	6,588	16,969	5,434	3,132	103,290	14,190	50,198	20,243	18,659
SEP$_p$	30,531	5,878	16,065	6,094	2,504	114,357	15,530	50,579	29,268	18,980
1984 TOTAL	264,193	50,100	146,184	47,065	20,844					
1983 TOTAL	260,343	81,070	123,361	38,195	17,717					
9 MONTHS										
1985	236,017	42,408	125,773	44,761	23,075					
1984	199,155	34,630	113,185	36,589	14,751					
1983	157,881	48,595	66,712	28,797	13,777					
1982	74,886	26,094	30,061	14,036	4,695					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1985												
SEP	201	82	26	93	130	8,545	47	2,771	20	1,318	63	4,456
OCT	205	84	24	97	122	8,308	34	2,041	16	1,120	72	5,147
NOV	173	78	27	68	128	8,488	47	2,795	25	1,693	56	4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
FEB$_p$	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
2 MONTHS												
1986	416	266	49	101	207	13,892	90	5,432	37	2,546	80	5,914
1985	215	49	30	136	166	10,760	30	1,704	24	1,590	112	7,466
1984	244	53	36	155	210	13,484	34	1,846	66	2,993	129	8,645
1983	275	137	57	81	116	6,808	31	1,432	25	1,591	60	3,785

SECONDARY MARKET ACTIVITY
(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
SEP	1,638	1,739	48,769	3,654	2,757	2,919	4,219	4,501	6,927	4,403
OCT	1,733	1,767	50,363	2,228	4,169	3,995	3,215	3,081	6,849	5,795
NOV	1,199	1,624	52,198	2,469	5,394	4,354	3,681	3,449	6,059	5,251
DEC	1,858	1,663	54,987	3,365	3,076	3,425	6,095	6,335	5,699	4,520
1986										
JAN	1,315	1,188	58,391	3,964	4,880	5,273	3,709	3,300	10,103	5,298
FEBp	2,578	1,159	60,752	2,978	n.a.	n.a.	n.a.	n.a.	5,973	[illegible]
1984 TOTAL	21,007	16,721	—	13,546	30,743	32,601	21,885	20,489	36,101	27,857
1983 TOTAL	18,607	17,553	—	13,340	30,921	32,846	22,952	21,376	70,280	50,496
2 MONTHS										
1986	3,893	2,347	—	6,942	4,880	5,273	3,709	3,300	16,076	10,304
1985	3,195	3,502	—	2,733	7,573	7,886	5,444	4,409	8,755	5,354
1984	3,702	1,285	—	1,377	2,420	2,855	2,808	978	6,922	5,748
1983	2,790	3,639	—	2,295	2,851	2,927	3,167	3,397	8,909	6,230

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES: FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1985								
SEP	12.04%	12.02%	12.03%	11.17%	11.20%	10.54%	11.775%	13.21%
OCT	11.87	11.86	11.88	11.09	11.32	10.50	11.575	13.03
NOV	11.28	11.56	11.58	11.01	11.26	10.26	11.160	12.38
DEC	10.70	11.03	11.03	10.94	11.12	9.94	10.425	12.06
1986								
JAN	10.78	10.82	10.93	10.89	10.81	10.00	10.375	12.00
FEB	10.59	10.49	10.50	10.68	10.83	9.89	10.269	11.63
MARp	n.a.	n.a.	n.a.	10.48	10.63	9.04	9.494	11.09

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
SEP	11.41%	11.43%	11.47%	11.87%	10.37%	7.27%	7.83%
OCT	11.24	11.28	11.34	11.82	10.24	7.33	7.80
NOV	10.75	10.95	11.01	11.38	9.78	7.30	7.77
DEC	10.02	n.a.	n.a.	10.91	9.26	7.14	7.75
1986							
JAN	9.99	10.18	10.22	10.74	9.19	7.16	7.71
FEB	9.75	9.90	9.95	10.21	8.70	7.11	7.63
MARp	9.05	9.23	9.27	9.41	7.78	6.57	7.20

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
SEP	17	104	106	110
OCT	49	100	104	110
NOV	(10)	97	117	123
DEC	(21)	76	n.a.	n.a.
1986				
JAN	4	80	99	103
FEB	38	105	120	125
MARp	n.a.	127	145	149

n.a.—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

* = 11 Month Totals

MORTGAGE BANKING ACTIVITY
LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED Total	1-4 Units Total	1-4 Units FHA	1-4 Units VA	1-4 Units Conv.	5+ Units Total	5+ Units FHA	5+ Units Conv.	Non-res.[3]	SEASONALLY ADJUSTED Total[2]	1-4 Units	5+ Units	Non-res.[3]
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,080	[illegible]	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH To Borrowers Total	To Borrowers 1-4 Units	To Borrowers 5+ Units	To Borrowers Non-res.[3]	From Investors Total	From Investors 1-4 Units	From Investors 5+ Units	From Investors Non-res.[3]	OUTSTANDING COMMITMENTS END OF MONTH To Borrowers 1-4 Units	To Borrowers 5+ Units	To Borrowers Non-res.[3]	From Investors 1-4 Units	From Investors 5+ Units	From Investors Non-res.[3]
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,860	3,910	60	890	7,890	100	760	7,810	200	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH	Total	1-4 Units Total	1-4 Units FHA	1-4 Units VA	1-4 Units Conv.	5+ Units Total	5+ Units FHA	5+ Units Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,000	1,500	880	3,610	170	0	170	[illegible]

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4] 1-4 Units	COVERAGE[4] 5+ Units	COVERAGE[4] Non-[3] res.	SERVICING VOLUME[1] Total	SERVICING VOLUME[1] 1-4 Units	SERVICING VOLUME[1] 5+ Units	SERVICING VOLUME[1] Non.[3] res.	NOTES PAYABLE[1] (End of Month Balances) Total	NOTES PAYABLE[1] Comm. Paper	NOTES PAYABLE[1] To Banks	NOTES PAYABLE[1] To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	56	88	385,270	321,620	33,110	30,540	42,280	8,390	23,880	[illegible]

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED Total	CONSTRUCTION LOANS CLOSED 1-4 Units	CONSTRUCTION LOANS CLOSED 5+ Units	CONSTRUCTION LOANS CLOSED Non-[3] res.	DISBURSEMENTS DURING MONTH Total	DISBURSEMENTS DURING MONTH 1-4 Units	DISBURSEMENTS DURING MONTH 5+ Units	DISBURSEMENTS DURING MONTH Non-[3] res.	DISBURSEMENTS DURING MONTH Land Loans	END OF MONTH INVENTORY Total	END OF MONTH INVENTORY 1-4 Units	END OF MONTH INVENTORY 5+ Units	END OF MONTH INVENTORY Non-[3] res.	END OF MONTH INVENTORY Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	8,240	3,790	790	4,660	[illegible]

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH Total	ISSUED DURING MONTH 1-4 Units	ISSUED DURING MONTH 5+ Units	ISSUED DURING MONTH Non-[3] res.	END OF MONTH BALANCES Total	END OF MONTH BALANCES 1-4 Units	END OF MONTH BALANCES 5+ Units	END OF MONTH BALANCES Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,510	505	280	2,790

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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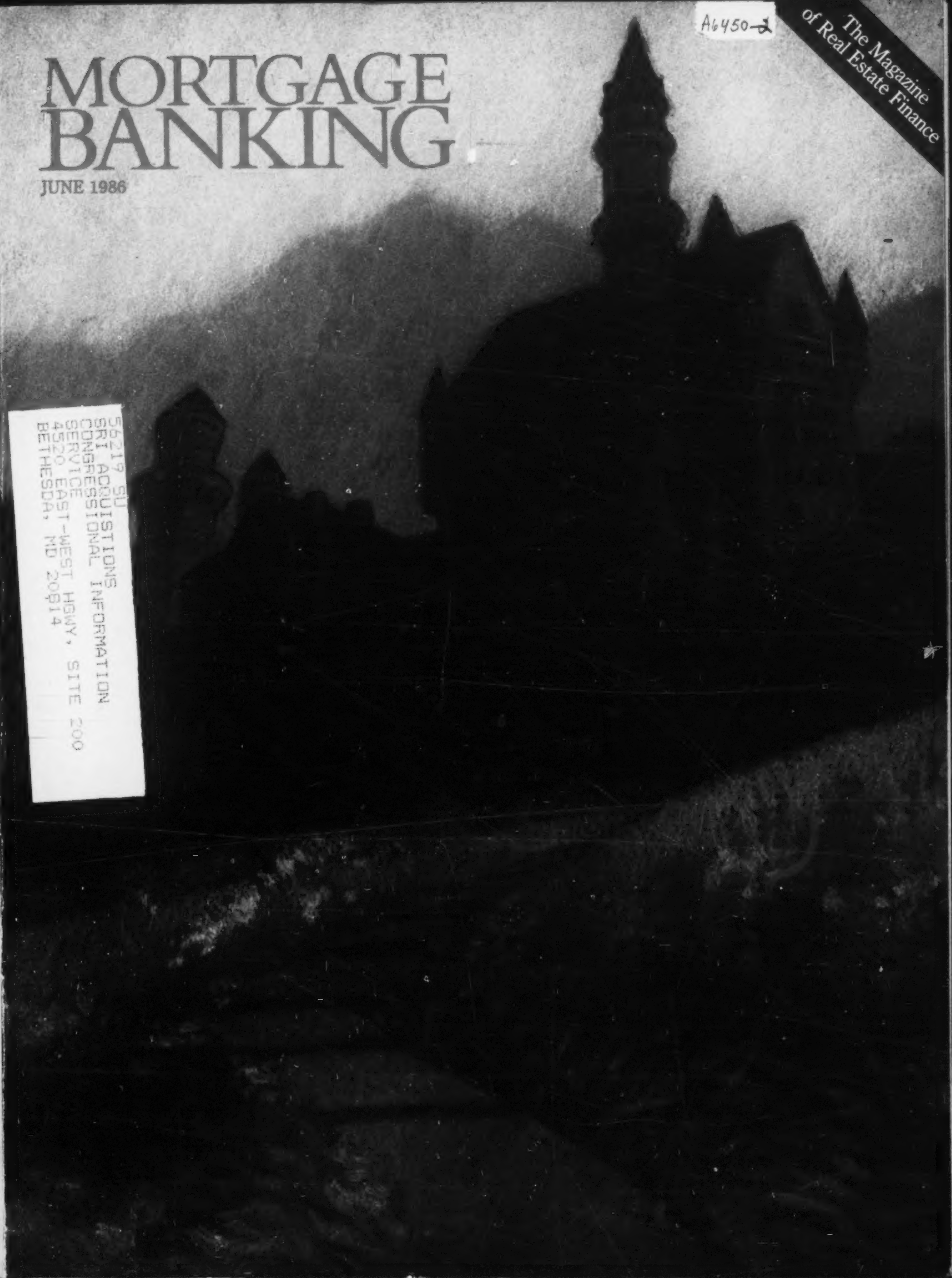

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TAPPING HOME EQUITY

A Cause For Concern?

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One of the most rapidly growing segments of consumer finance in the nation is the home equity loan—a loan secured by a second mortgage on the borrower's home.[1] In 1971, there was less than $5 billion of second mortgage credit outstanding in the United States. By 1981, second mortgage debt had grown to more than $40 billion.[2] In 1985, an estimated $55 billion of new second mortgage loans had been originated.[3] It is estimated that two of every five mortgage loans originated is a second.[4]

Several factors have fueled this growth. Rapid rates of appreciation in the value of housing inflated the equity of most homeowners during the late 1970s. As a consequence, many homeowners held a large amount of wealth that could be converted to cash by adding a second mortgage. Second, interest rates on consumer credit escalated during the same period, making the cost of second mortgage credit more attractive. The introduction of home equity access programs by major financial companies has made second mortgages a more feasible substitute for personal loans. Lenders are attracted to second mortgages because delinquency rates have been low relative to unsecured forms of credit.[5] Today in the New York area, home equity loans are originated at rates ranging from 10.75 to 12 percent.[6]

Such growth has not occurred without incident. In California during the late 1970s, a flurry of second mortgage activity caused a major scandal. The combination of loan underwriting by noninstitutional lenders (mortgage brokers who packaged seconds for sale to investors) and an unanticipated softening of the resale market left investors and borrowers in trouble. Fascinated by the profit potential in residential real estate, investors clamored for a piece of the action. Some mortgage brokers were all too happy to accommodate, sometimes originating as many as nine loans on one home.[7] As values declined, borrowers walked away leaving the investors to scramble over what was left.

Today, growth in property values is settling down to a more sustainable level than a few years ago. In addition, first mortgage foreclosures are running at high rates. However, aggressive plans are underway to expand the second mortgage business.[8] Are we headed for a debacle similar to the California incident? Is the expansion of second mortgage debt cause for concern in today's economy?

The issue of home equity loans was highlighted recently in the Texas legislature. Texas has the oldest and most restrictive homestead law in the country, a constitutional provision that dates back to the days before statehood. The law effectively eliminates second mortgage loans on homestead property except to assist in initial purchase, making home improvements or satisfying a tax lien on the property. Any increase in the debt burden on the home after purchase is ruled out, either through junior financing or refinancing of the principal loan. This is accomplished by refusing to recognize any lien established through such a loan. The primary purpose of the provision is to prevent loss of the home due to imprudent acts of the homeowner.

Texas homeowners have unencumbered equity in their homes estimated at more than $150 billion.[9] Yet that vast store of wealth is unavailable to homeowners unless they sell their homes. A coalition of lenders interested in introducing home equity programs in the state has been working for the past several years to change the homestead law. Opposition to the change, which includes the Texas Association of Realtors, has succeeded in frustrating the move thus far. The ensuing debate, however, has served to focus attention on the merits and hazards of an expanded second mortgage market. Some of the major points are summarized.[10]

The backers of homestead revision have produced figures that indicate the significant amount of economic stimulus that would be produced by a broader second mortgage market. They have also commissioned public opinion polls that show broad support for the right to access homeowner equity through second mortgage financing.

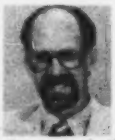
The most important beneficial effects of allowing home equity access programs, however, are the expanded options available to the homeowner. The availability of a viable credit market for second mortgages makes the home a more liquid investment and may provide a more affordable alternative to unsecured personal credit.

Many homeowners have a substantial amount of wealth built up in the equity of their homes. Most commonly this is due to the rapid increase in property values during the last decade. In other cases, owners may have increased their equity as a result of a large cash investment at purchase to assume an existing low interest rate loan or as a strategy to limit interest expenses on new loans (possibly as part of the new "fast pay" mortgages). If this wealth is forced to remain in the house until resale, the owner may have to forego opportunities to invest in a business or a child's education, possibly more valued prospects than equity. Selling the home may be inconvenient, undesirable or impractical.

Advantages

The other major advantage of a home equity access program is the possibility that credit could be arranged at lower cost than alternative sources. Because second mortgages have become more common since 1980, interest rates have declined due to favorable experience on delinquency rates. In fact, the rates on second and first mortgages are converging, despite the difference in the collateral quality of the liens.[11] Most equity access programs peg their rates to the prime interest rate, generally with a 1 to 3 percent spread. At current levels, the prime rate is approximately 1 percentage point below first mortgage rates on fixed-rate loans. The rate is much lower than the rates on personal loans and this is a major factor in their popularity.[12]

The cost comparison to unsecured credit must be tempered by two considerations. First, second mortgages involve substantial initial costs to originate. Generally, there are credit checks, appraisals, fees and possibly a new title insurance policy.[13] These costs can make second mortgages impractical for relatively small loan amounts. Some of the problem is obviated by the revolving loan programs because a line of credit can be established and drawn upon as needed without the need for additional fees for each draw. However, the borrower will feel pressured to eventually use the full line of credit that has been essentially paid for through the initial fees. Therefore, there is an incentive to maximize debt.



Dr. Jack Harris is associate research economist for the Texas Real Estate Research Center in College Station, Texas. He is coauthor of Barron's Real Estate Handbook *and has written several articles on mortgage finance and other real estate topics. He formerly held a position in the Georgia Office of Planning and Budget.*

Secondly, most equity access programs apply a variable interest rate to the loans. In some cases, the rate may be adjusted each day. Unlike first mortgage adjustable loans, there rarely are adjustment caps.[14] The borrower has no assurance that the loan, which is a bargain at origination, does not become the unaffordable loan in the future.

Concerns

There were a variety of concerns expressed about the possibility of liberalizing the homestead laws in Texas. While directed toward second mortgages in general, the concerns are especially appropriate for home equity access plans. It is possible to boil down most of the rhetoric to three major points: foreclosure risk, extinction of unsecured credit and complication of the home sales transaction.

The fear of higher rates in mortgage foreclosures is based on the greater level of debt that would be heaped upon both the homeowner and the property. Investigations of mortgage foreclosures show that an increasing debt service burden, relative to income, promotes borrower delinquency. When combined with eroding equity, caused by stagnant or declining property values, this rising burden leads to default.[15] Equity access programs increase the chances of both delinquency and default. The added burden of second mortgage payments may be exacerbated by variable interest rates during a time of rising rate indexes. If the owner's equity is depleted by the existence of the second lien, it increases the probability that the value of the home on the market may fail to cover the accumulated debt.

Two other factors were mentioned by the opponents of the homestead revision as contributors to the foreclosure problem. In many cases, a second mortgage will probably be taken out to finance the purchase of a good with a life expectancy shorter than the term of the loan. For example, one may use the loan to purchase an automobile. In five years, one may have a worn-out car, but many years of additional mortgage payments remaining. Will the borrower still be as diligent about meeting such a financial obligation, when all the pleasure of the purchase has gone?

Possibly a more serious concern is the problem of inexperienced lenders. There was some fear of an explosion of second mortgage originations by lenders accustomed to unsecured credit. Loose underwriting procedures may be encouraged by the belief that any loan secured by the borrower's home would be solid.

These last two points are, of course, speculations and are not conducive to empirical testing. The first point about thinner equity is based on both theoretical and empirical studies. How-

> *"The availability of a viable credit market for second mortgages makes the home a more liquid investment and may provide a more affordable alternative to unsecured personal credit."*

ever, the period when equity access programs have risen in prominence has not been accompanied by rising foreclosure rates on seconds. (Actually, the experience has run in the opposite direction.[16]) As a crude test, one might compare the foreclosure experience of Texas lenders to those in other states. Table 1 shows average foreclosure rates for the regional federal home loan banks, as well as the average unemployment rates for each region. Although Texas is only one state in its region, it comprises about 80 percent of the loan volume in the region.

The Texas region does have one of the lowest foreclosure rates in the country during this period (although the state had one of the highest rates in 1985). However, this probably has more to do with the fact that Texas also had one of the strongest economies in the country than the unique nature of its homestead law.[17] Some regions suffered higher rates of unemployment during the period, yet had lower rates of foreclosure.

The second major concern involved the continuing availability of unsecured credit. It is probably no secret that lenders prefer collateral to no security for their loans. Therefore, it is logical to expect second mortgages to gain in popularity with lenders. Unless the overall credit market expands, there will have to be some substitution of secured credit for unsecured credit for second mortgage debt to grow. Indeed, some equity access programs even offer VISA debit cards to function much like credit cards, except the credit goes directly to the account secured by the mortgage.[18]

Growing popularity of equity access programs, however, may not be a sign that unsecured credit is drying up. Part of the growth is, undoubtedly, due to demand by borrowers for larger credit lines on more favorable terms than those available on unsecured loans. As long as there is a demand for unsecured lines of credit, some lender will oblige. There is a rather substan-

TABLE 1

Average Mortgage Foreclosure And Unemployment Rates Compared For Regions Of The U.S. 1978-1982

Region	Foreclosure Rate (% of loans held)	Unemployment Rate (% of labor force)
New England	.080	6.3
New York/New Jersey	.105	7.5
Penn.-Del.-W. Va.	.088	8.1
Southeast	.052	6.7
Ky.-Tenn.-Ohio	.121	8.2
Ind.-Mich.	.130	10.1
Ill.-Wis.	.127	7.8
Upper Plains	.102	6.2
Tex.-Ark.-La.-N.M.-Miss.	.072	6.0
Lower Plains	.082	4.9
Cal.-Ariz.-Nev.	.053	7.3
Northwest-Mountains	.104	7.6

Sources: Federal Home Loan Bank, Bureau of Labor Statistics

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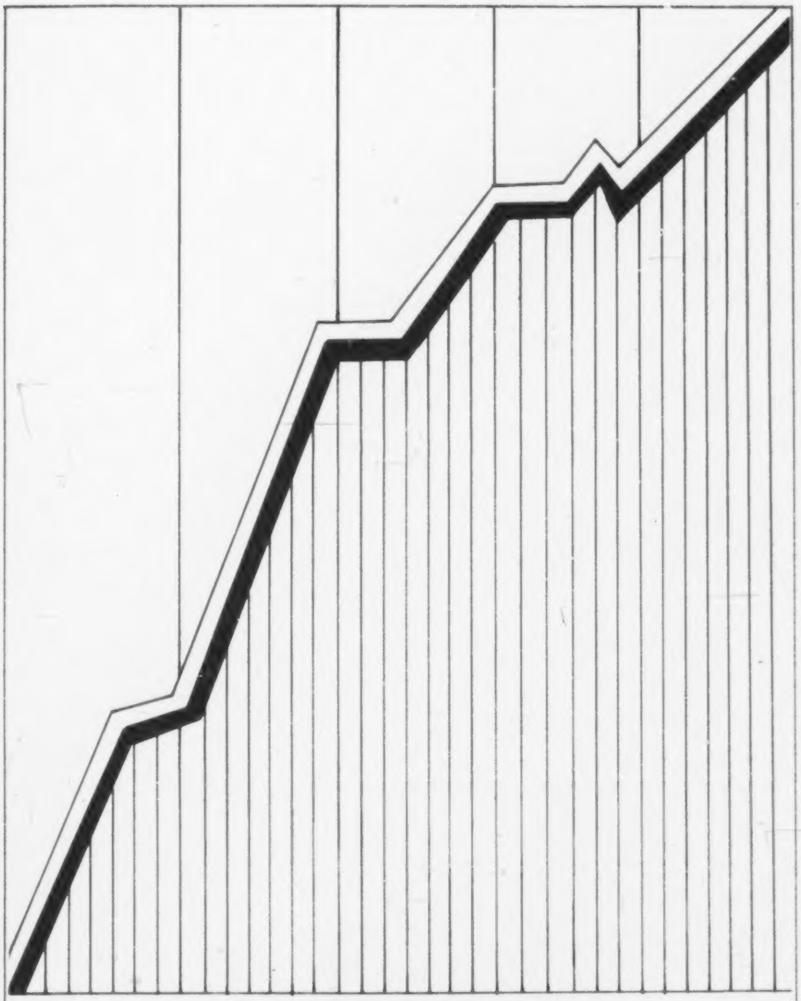
> *"The other major advantage of a home equity access program is the possibility that credit could be arranged at lower cost than alternative sources."*

tial, hard-core demand for such credit: nonhomeowners, those who would rather pay more to avoid risking their home and those whose credit needs are too small to justify a second mortgage.

The third major reservation about equity access programs was their possible effect on home sales. Undoubtedly, this was the reason that the real estate brokerage industry in Texas chose to officially oppose the homestead revision. The existence of second mortgages might affect sales in three ways, and in each case, the effect would be to reduce the frequency of sales.

First, the existence of additional liens on the home tends to complicate the process of transferring title. In most cases, arrangements must be made to pay off the loans to clear the title for a sale. While this procedure could probably be handled smoothly in most cases, the probability of a delayed or even aborted closing and sale is increased.

Also, the dissipation of homeowner's equity through second mortgages may discourage upgrading of housing. The forced savings program represented by the amortizing mortgage loan, combined with appreciation, allows many homeowners to buy a more spacious, luxurious, more up-to-date or better located home as their needs change. If this equity has been drawn down by increasing debt, the owner may be forced to stay put. Of course, this rests on the premise that homeowners would respond to the availability of second mortgages by expanding their overall level of borrowing, rather



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than merely substituting mortgage financing for unsecured loans. A homeowner with little unencumbered equity, but debt-free otherwise, may be able to buy a better home just as well as one with abundant equity, but laden with installment debt.

The third reason why second mortgages may reduce home sales is that the ability to access equity without resorting to a sale should eliminate those sales induced solely by the necessity to obtain cash. It is impossible to measure how important such sales are relative to overall sales volume. One suspects they are rather infrequent. The sale of a home is a drastic and expensive method for gaining extra cash. Thus, it would probably be reserved for dire emergencies.

While there is some reason to expect second mortgages to affect home sales, there is even more reason to expect that effect to be minor. In Texas, where second mortgages are limited, housing markets have been very active in recent years. However, when the rapid growth of the state is considered, the market activity does not appear unusual compared to the rest of the nation. Available data do not suggest the restriction on second mortgages has been instrumental in sustaining activity in the housing market.[19]

Threat or opportunity?

Some observers decry the American propensity to dig ever deeply into debt.[20] Easy access to credit cards, inviting consumer credit programs and new mortgage instruments designed to stretch loan qualifying criteria are seen as symptomatic of a greater problem of financial irresponsibility. In this view, the growing popularity of home equity access programs is merely another way for individuals to sacrifice future financial security. With Third World countries apparently hopelessly in debt and American farmers in serious trouble, will the homeowner be the next to join the line of debtors?

There are good reasons to discount this apparent threat. The latest generation of homeowners has sacrificed dearly to purchase their homes. In many cases, two wage earners in the family were required. Even then, the burden of mortgage payments was high. Under these circumstances, these owners should be very reluctant to jeopardize their investment through additional borrowing. Those most attracted to equity loan programs will probably be those who purchased some time ago. They have seen their equity grow to the point of being their most significant source of personal wealth. Borrowing on this wealth can be a prudent act when a legitimate need arises.

Debt, per se, is not bad. As long as the purposes are worthwhile, from the borrower's viewpoint, and the loans are based on solid underwriting procedures, there should be little concern. Problems could arise should property values decline significantly. Values of single-family homes have already corrected most of any speculative premium acquired during the price escalation of the late 1970s.[21] Therefore, most homeowners' equity should be relatively solid. The real concern is whether or not homeowners will continue to act prudently when faced with new opportunities to hock their future earning capacity. In a country founded on freedom, we have to take that risk. ☐

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[19] According to data from the National Association of Realtors and the Bureau of the Census, the South region had the most active housing market in 1975-1980 with more than $16 in sales per person per year. The region was the second fastest growing with a 20 percent increase in population during the 1970s. The Northcentral region had slightly less than $16 in per capita sales, yet grew by only 4 percent during the decade.
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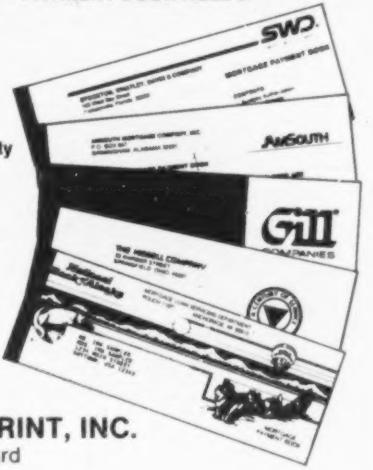

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MORTGAGE MARKET TRENDS

In the first quarter of 1986, the nation's output of goods and services grew at an annual rate of 3.2 percent, up from 0.7 percent in the fourth quarter. Real net exports declined sharply in the fourth quarter and then recovered in the first. Considerable improvement also occurred in consumer spending and the housing sector. Consumer spending was helped by falling or stable prices for many goods. This helped boost real disposable income. In addition, the steep decline in interest rates has strongly benefited the housing sector. Nevertheless, there are still some underlying weaknesses in the economy. For instance, the manufacturing sector continues to perform poorly, primarily due to stiff import competition. In addition, business fixed investment, which has been sluggish, is not expected to strengthen. Moreover, the proposed tax reform bill, if passed, will have some negative effects on economic growth in the short-run.

Over the near term, the business investment picture is far from rosy. Real nonresidential fixed investment fell at an annual rate of 13 percent in the first quarter, with producers' durable equipment purchases decreasing by more than $12 billion. Some recovery in this component of investment will likely occur in the second quarter. However, due to the drop in oil prices, spending on oil and gas exploration has collapsed and is not expected to improve in the near future. Finally, the surge in business inventories was not as positive as it appears on the surface. Part of the first quarter's rise, particularly for automobiles, reflected an involuntary build-up of inventory, as sales fell sharply behind production. Auto production will probably be down in the second quarter, as producers seek to work down unwanted stockpiles.

Despite the sharp decline of the dollar, the manufacturing sector has yet to show signs of snapping out of its doldrums. For example, March orders at U.S. factories for manufactured goods fell by more than 2 percent, continuing the weakness in this sector that was evident in the first two months of the quarter. After declining by 0.8 percent and 0.7 percent respectively, in the preceding two months, industrial production rose by only 0.2 percent in April. As a consequence, there has been a corresponding downward drift in capacity utilization.

The soaring merchandise trade deficit is a reflection of the troubles that are besetting American manufacturers. In March, the net import figure widened to $14.5 billion, with much of the deficit coming from the importation of manufactured goods, which climbed to an all-time high.

On the positive side, the value of the dollar has dropped significantly in the past 15 months. Since peaking in the first quarter of 1985, the dollar has fallen more than 30 percent against a composite of currencies. Not surprisingly, the effects of the falling dollar are not yet fully reflected in the trade balance. Hopefully, by the end of the year, the effects of the falling dollar will be reflected in a pick up in activity in the manufacturing sector and a corresponding decline in the merchandise trade deficit.

Another reason for optimism is the substantial progress that has been made in bringing down inflation. There are a number of reasons, including the absence of any undue demand pressures on industrial or labor resources, for this improvement. However, tumbling oil prices have been the major factor behind the sharp decline in inflation. The producer price index has fallen for four straight months. Retail prices, with a lag, have also declined this year. The consecutive 0.4 percent drops in the consumer price index in March and April have given consumers the biggest two-month price decline in 36 years. Inflation is expected to continue to be very moderate over the near term and then rise during the latter part of the year as oil prices stabilize. For the year, the rate of consumer price inflation will probably be well below 3 percent.

The weakness of the economy, the improved outlook for inflation and the prospects for lower federal budget deficits are all having a significant impact on the money and capital markets. Since the fourth quarter of the last year, rates on both short- and long-term maturities have been trending downward. Presently, the yields on short-term market instruments are slightly more than 6 percent, while long-term rates are averaging about 7½ to 8 percent. Moreover, lenders are now offering mortgage rates of about 9½ to 10 percent. In addition, while Federal Reserve officials have been reluctant to push interest rates down, they have allowed the rates they control directly to follow the market-determined rates downward. Thus, there have been two cuts in the discount rate in the past two months. Currently, the discount rate is 6.5 percent and the prime rate is 8.5 percent. Market rates may drop somewhat more during the near term, as the economy continues its sluggish growth pattern. Therefore, after the Federal Reserve has had time to evaluate the effects of its latest actions, another cut in the discount rate is possible.

The continuing declines in mortgage rates has proven to be very beneficial to both housing sales and construction. New home sales, at an annual rate amounted to 903,000 units in March. This rate is 27 percent above February's figure and is the highest rate on record. Sales of existing homes have also been relatively strong, remaining above the 3 million unit level for 12 consecutive months.

Lenders are also dealing with an extraordinarily high volume of refinancing. Recent estimates indicate that about 40 to 50 percent of all originations are refinancings. Thus, between housing sales and refinancings, loan activity has been very strong this year. In addition, new home construction has also been quite robust. After averaging well above 1.9 million units at an annual rate in the first three months of the year, housing starts rose by another 4 percent in April to a 2 million unit pace.

With mortgage rates expected to decline somewhat more during the near term, starts and sales levels should continue to be robust. Even after rates stabilize later in the year, the housing sector will continue to be a source of strength in the economy.

On balance then, over the near term, the slowing in aggregate sales and production, particularly for automobiles and the cutbacks in investments, mainly in the oil industry, will keep economic growth at a relatively low level at least through the end of the current quarter. However, as the beneficial effects of declining or stable prices and lower interest rates begin to be felt later this year, consumer spending should be reinvigorated. This should improve production and operating rates and overall economic growth should turn up.

Robert Rosenblatt
Assistant Economist
May 21, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
NOV	125	80	45	1,566	1,041	525	120	74	47	1,661	1,029	632
DEC	115	71	44	1,882	1,181	701	128	68	60	1,873	1,101	763
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,907	1,223	684
FEB	107	71	36	1,997	1,319	678	109	68	41	1,803	1,147	656
MAR	149	103	46	1,930	1,289	641	152	99	53	1,834	1,150	684
APR	188	129	59	2,009	1,346	663	180	125	55	1,883	1,256	627
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
4 MONTHS												
1986	560	382	178				561	365	196			
1985	521	354	167				518	331	186			
1984	546	384	162				558	362	196			
1983	458	327	131				452	298	154			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
NOV	20	17	57	30	235	210	767	442	21	16	52	32	270	202	716	473
DEC	17	13	57	34	283	261	870	468	19	17	62	30	276	295	862	440
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	304	329	770	504
FEB	13	11	51	33	411	364	744	478	12	12	53	32	301	306	727	469
MAR	20	21	69	39	326	338	763	503	21	20	64	46	276	287	718	553
APR	30	32	79	50	329	358	802	520	29	32	69	42	303	328	724	538
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
4 MONTHS																
1986	76	73	258	152					76	76	247	162				
1985	59	54	261	148					70	55	243	150				
1984	44	56	303	146					51	57	293	157				
1983	40	45	274	100					39	43	266	104				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
OCT	301	52	358	6.5	$204.2	$85.3	$30.3	$88.6	1,087	633	456	151	110	41
NOV	246	51	357	6.1	205.1	86.0	29.2	89.9	1,087	627	460	143	100	43
DEC	221	47	352	5.8	210.4	86.6	29.9	93.9	1,088	618	471	162	113	49
1986														
JAN	213	54	353	6.2	212.2	89.0	29.7	92.5	1,094	628	466	122	81	41
FEB	218	58	347	6.4	214.2	92.4	29.4	92.4	1,111	639	472	118	76	42
MAR$_p$	280	87	333	4.6	211.9	91.5	30.0	90.4	1,101	628	473	134	92	41
1985 TOTAL	3,216	686										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
3 MONTHS														
1986	711	200										374	250	124
1985	645	170										365	247	118
1984	643	173										341	235	106
1983	555	147										247	177	70

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$33,017	$5,869	$12,665	$12,370	$2,113	$21,151	$5,286	$9,551	$6,232	$82
JUL	31,407	6,503	11,709	11,051	2,144	21,273	5,969	9,093	6,110	101
AUG	34,928	7,792	13,324	11,832	1,980	25,518	7,028	10,996	7,390	104
SEP	35,188	7,422	13,316	12,346	2,104	24,104	6,963	10,483	6,541	117
OCT	36,525	6,548	14,014	13,288	2,675	24,450	6,104	11,032	7,208	106
NOV$_p$	32,864	5,660	12,363	11,886	2,955	21,142	5,200	9,357	6,441	94
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983 TOTAL	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
11 MONTHS										
1985	325,757	62,335	129,453	111,684	22,285	218,660	57,500	99,185	61,062	913
1984	266,922	46,279	118,863	88,361	13,419	183,239	43,384	89,273	49,836	746
1983	247,709	57,539	93,329	84,040	12,801	180,773	54,164	74,083	51,902	624
1982	113,112	26,175	36,990	43,139	6,808	79,226	23,759	30,005	24,986	476

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$2,519	$ 418	$1,417	$590	$94	$9,347	$165	$1,697	$5,548	$1,937
JUL	1,804	53	974	604	173	8,330	481	1,642	4,337	1,870
AUG	2,201	239	1,085	665	212	7,209	525	1,243	3,777	1,664
SEP	2,202	287	1,099	656	160	8,882	172	1,734	5,149	1,827
OCT	2,694	150	1,456	700	388	9,381	294	1,526	5,380	2,181
NOV	2,585	183	1,401	756	245	9,137	277	1,606	4,739	2,515
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983 TOTAL	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
11 MONTHS										
1985	22,986	2,122	12,669	6,151	2,044	84,111	2,713	17,599	44,471	19,328
1984	18,138	401	11,672	5,031	1,034	65,545	2,494	17,918	33,494	11,639
1983	14,036	553	7,525	4,660	1,298	52,900	2,822	11,721	27,478	10,879
1982	5,761	901	2,566	1,929	365	28,125	1,515	4,419	16,224	5,967

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$28,091	$5,731	$14,174	$5,385	$2,801	$105,354	$13,116	$56,079	$19,126	$17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,706	14,684	49,838	17,882	17,302
AUG	32,123	6,588	16,969	5,434	3,132	103,290	14,190	50,198	20,243	18,659
SEP	30,531	6,123	16,055	6,094	2,504	114,357	15,205	50,579	29,268	18,980
OCT	29,039	4,208	16,134	5,775	2,922	110,307	12,436	49,882	29,100	18,889
NOV	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
1984 TOTAL	249,401	70,128	146,184	47,065	20,844					
1983 TOTAL	258,986	44,893	123,361	38,195	17,717					
11 MONTHS										
1985	295,373	53,497	155,874	56,741	29,261					
1984	238,436	41,090	135,312	43,255	18,779					
1983	229,963	65,006	113,345	35,210	16,402					
1982	100,892	37,572	39,102	17,483	6,735					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
OCT	205	84	24	97	122	$8,308	34	$2,041	16	$1,120	72	$5,147
NOV	173	78	27	68	128	8,488	47	2,795	25	1,693	56	4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	NA	NA	33	61	NA	NA	NA	NA	23	1,621	35	2,654
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
3 MONTHS												
1986	NA	NA	82	162	NA	NA	NA	NA	60	4,167	115	8,568
1985	NA	NA	46	136	NA	NA	NA	NA	37	2,416	163	10,960
1984	NA	NA	55	266	NA	NA	NA	NA	65	4,194	201	13,350
1983	NA	NA	87	143	NA	NA	NA	NA	46	2,835	96	6,044

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1985										
OCT	1,733	1,767	50,363	2,228	4,169	3,995	3,215	3,081	6,849	5,795
NOV	1,199	1,624	52,198	2,469	5,394	4,854	3,681	3,449	6,059	5,251
DEC	1,858	1,663	54,987	3,365	3,076	3,425	6,095	6,335	5,699	4,520
1986										
JAN	1,315	1,188	58,391	3,964	4,880	5,273	3,709	3,300	10,103	5,298
FEB	2,578	1,159	60,752	2,978	n.a.	n.a.	n.a.	n.a.	5,973	5,006
MARp	1,917	1,410	62,310	2,078	n.a.	n.a.	n.a.	n.a.	14,853	5,058
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
3 MONTHS										
1986	5,810	3,757	—	9,020	NA	NA	NA	NA	30,929	15,362
1985	4,830	5,758	—	3,820	9,972	11,339	8,676	7,524	12,511	8,126
1984	5,328	4,822	—	3,783	3,724	4,728	4,099	3,184	10,005	8,235
1983	3,975	5,072	—	3,979	4,261	4,365	5,946	5,866	18,395	11,522

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA NEW[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1985								
OCT	11.87%	11.86%	11.88%	11.09%	11.32%	10.50%	11.575%	13.03%
NOV	11.28	11.56	11.58	11.01	11.26	10.26	11.160	12.38
DEC	10.70	11.03	11.03	10.94	11.12	9.94	10.425	12.06
1986								
JAN	10.78	10.82	10.93	10.89	10.81	10.00	10.375	12.00
FEB	10.59	10.49	10.50	10.68	10.83	9.89	10.269	11.63
MARp	n.a.	n.a.	n.a.	10.48	10.63	9.04	9.494	11.00

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
OCT	11.24%	11.28%	11.34%	11.82%	10.24%	7.33%	7.80%
NOV	10.75	10.95	11.01	11.38	9.78	7.30	7.77
DEC	10.02	n.a.	n.a.	10.91	9.26	7.14	7.75
1986							
JAN	9.99	10.18	10.22	10.74	9.19	7.16	7.71
FEB	9.75	9.90	9.95	10.21	8.70	7.11	7.63
MARp	9.05	9.23	9.27	9.41	7.78	6.57	7.20

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
OCT	49	100	104	110
NOV	(10)	97	117	123
DEC	(21)	76	n.a.	n.a.
1986				
JAN	4	80	99	103
FEB	38	105	120	125
MARp	n.a.	127	145	149

n.a.—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

* = 11 Month Totals

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED Total	1-4 Units Total	1-4 Units FHA	1-4 Units VA	1-4 Units Conv.	5+ Units Total	5+ Units FHA	5+ Units Conv.	Non-[3] res.	SEASONALLY ADJUSTED Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,880	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH To Borrowers Total	To Borrowers 1-4 Units	To Borrowers 5+ Units	To Borrowers Non-[3] res.	From Investors Total	From Investors 1-4 Units	From Investors 5+ Units	From Investors Non-[3] res.	OUTSTANDING COMMITMENTS END OF MONTH To Borrowers 1-4 Units	To Borrowers 5+ Units	To Borrowers Non-[3] res.	From Investors 1-4 Units	From Investors 5+ Units	From Investors Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	260	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH	Total	1-4 Units Total	1-4 Units FHA	1-4 Units VA	1-4 Units Conv.	5+ Units Total	5+ Units FHA	5+ Units Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	[illegible]

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	66	96	68	385,270	321,620	33,110	30,540	42,280	8,300	20,680	[illegible]

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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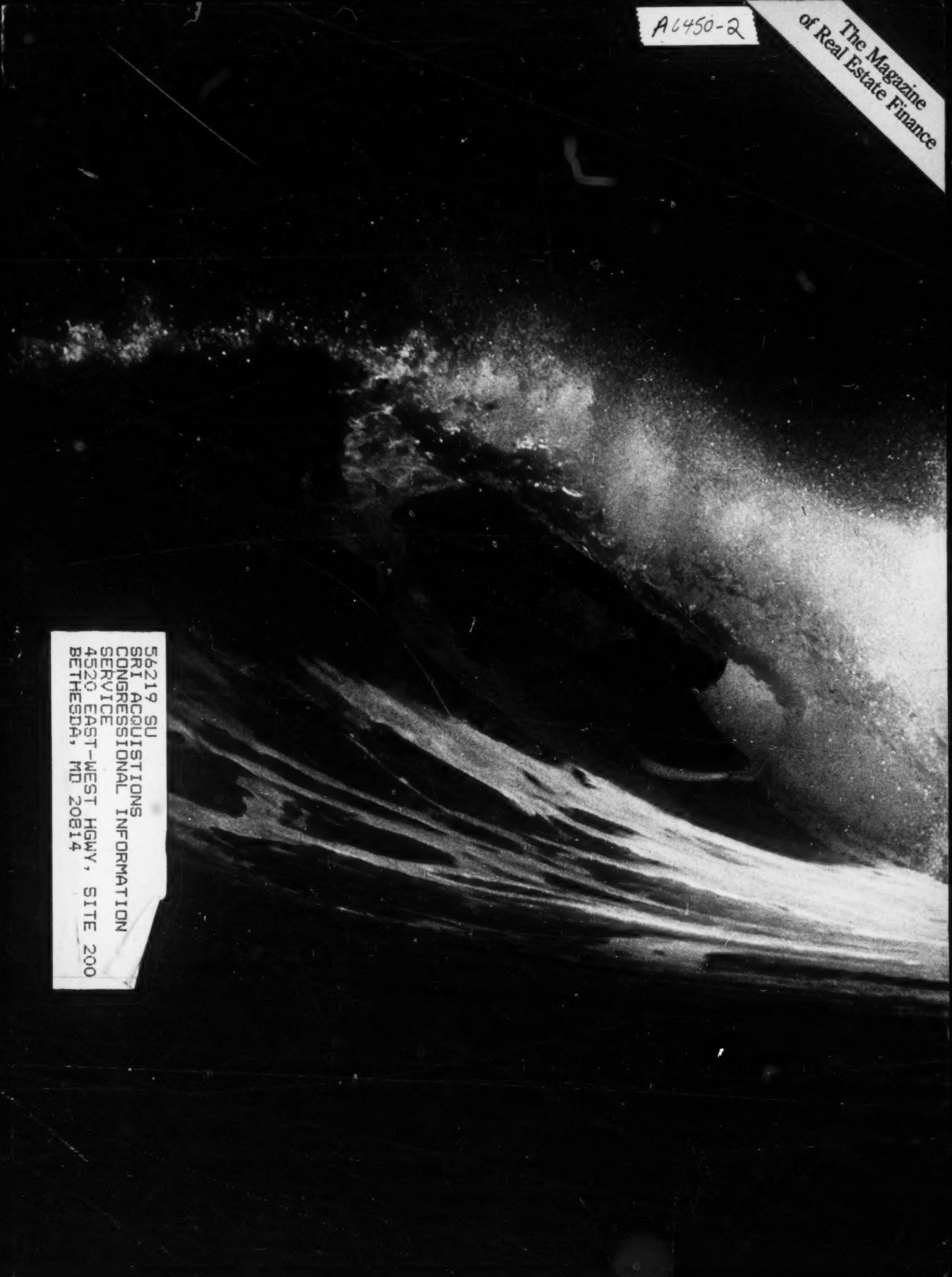

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MORTGAGE BANKING

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SOLD
SOLD
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THE BIG FALL

Trendsetters for Real Estate Finance in 1985

Nineteen hundred and eighty five will go down in history as one of the banner years for the housing industry. New single-family home sales reached 687,000 units (639,000 in 1984) and existing single-family home sales set a record for the 1980s at 3,214,000 units—a 12 percent increase over the 1984 figure. Nevertheless, there were some soft spots in the industry last year even with the declining interest rates. For example, although single-family starts totalled 1,072,400 units, the 1984 figure exceeded 1,084,000. As a consequence, the total starts figure of 1,741,800 units did not perform up to the 1984 level of 1,749,500 units.

The omnipresent factor driving the 1985 housing market was the steady decline in mortgage rates that began about the middle of the summer. According to Federal Home Loan Bank Board figures, effective rates on conventional, 30-year, fixed-rate mortgage (FRM) loans at the beginning of the year were about 13 percent while adjustable rate mortgage (ARM) loans carried average effective rates around 12 percent (See Table 1).[1] However, by July, these rates had begun to decline and effective rates on FRM product were less than 12.25 percent, with ARMs just more than 10.75 percent. By the end of the year, effective financing costs on fixed-rates and adjustables were below 12 percent and 10.5 percent, respectively.

During the past few years, declining rates have greatly stimulated the home resales and mortgage refinancing markets. However, the less obvious effects have been the shifts in the use of various types of mortgage instruments and the sources of the funds for these loans. The substantial fall in effective rates on 30-year, level payment loans stimulated their demand relative to that for adjustable rate mortgages and although the 1985 basis point declines in rates on ARMs were greater than those for FRMs, the use of adjustables dropped substantially in late 1985. Moreover, indications are that a large portion of the

ILLUSTRATION BY FRED SCHRIER

substantial volume of lending, since the end of 1985, has been to refinance existing ARM loans with fixed-rate instruments. Furthermore, a result of the current relatively low interest rate environment is that more than a 150 basis point differential is now needed between fixed-rates and ARMs to make them close substitutes in the eyes of mortgage borrowers. However, many existing ARMs are working on their second and third adjustments and actually may be establishing new rates, which are just slightly higher than those currently offered on FRMs. Due to the uncertainty of future levels of mortgage interest rates, many of these ARMs may turn out to be better instruments in the long run.

Data sources for the housing and home financing market

Analysts of the housing and mortgage industry rely on a variety of data and information sources to track these markets. Most of the primary mortgage market data is provided through federal government surveys—the Federal Home Loan Bank Board (FHLBB) series on financing terms for conventional loans and the U.S. Department of Housing and Urban Development (HUD) survey of mortgage lending activity.[2] The Bureau of the Census also collects detailed information on the characteristics of mortgage loans, properties and property owners, however, it is collected as part of the deci-annual Census of Housing.[3] As a consequence, its primary usefulness is in the periodic bench marking of other series.

The FHLBB publishes monthly statistics based on closings and commitments in the first week of each month. These figures are reported for conventional, fixed-rate and adjustable rate first mortgage loans from institutional lenders. The financial terms reported include averages of the contract and effective interest rates, loan-to-price ratio, fees as a percent of principal, term to maturity, loan amount and home purchase price. These figures are also provided for 32 metropolitan areas. These data are reported for savings and loan associations, mutual savings banks, commercial banks and mortgage companies as well as for all loans, fixed-rate loans, adjustables and for new and previously occupied homes. The FHLBB series also provides an estimate of the percent of adjustable rate loans closed at the beginning of that month.

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The HUD survey data are published on a monthly basis with quarterly updates and an annual report as well. These data measure monthly, quarterly and yearly gross dollar flows of originations, repayments and sales of long-term mortgage loans. These flows are reported for one to four family, nonfarm homes and multifamily properties and they are cross-classified by conventional, FHA-insured and VA-guaranteed loans. Individual data elements are reported for the four main classes of primary market originators—savings and loan associations, mutual savings banks, commercial banks and mortgage companies—as well as life insurance companies, private noninsured pension funds, real estate investment trusts (REITs), federal credit agencies and state and local retirement funds and credit agencies. The survey also provides similar information for holdings of land and construction and long-term mortgage loans.

MARKET FORCES
FED

The HUD figures provide a necessary picture of the aggregate dollar volume of mortgage transactions in primary and secondary mortgage markets. However, they provide no information on the use of various types of loan note instruments (i.e., fixed-rates, ARMs, graduated payment mortgages, etc.). While the series does provide relatively timely information on the sources of gross dollar loan flows by institution type, there have been many researchers who have wished the HUD series included as much detail on instruments.

There are several other important institutional publishers of mortgage financing information, including some of the major private and agency players such as Salomon Brothers Inc and Shearson Lehman Brothers Inc.,[4] the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac).[5] Their published data usually focus on secondary market yields and spreads, mortgage-related security issuance volumes and mortgage prepayment rates. As such, the information provided from these sources is important for overall mortgage market monitoring and analysis, but it does leave knowledge gaps on the primary market side.

The residential mortgage finance panel data

In the data collection arena, the National Association of Realtors (NAR) is primarily known for its series on the number of units, dollar volume and prices of existing homes sold by NAR members. This series provides housing market analysts with important measures of market activity because the resale home market accounts for about 75 to 85 percent of annual home sales. However, during the past three years, NAR researchers have been obtaining sample data on the characteristics of the financing, property and borrowers involved in these transactions. The residential mortgage finance panel (Panel) provides this information on a regularly scheduled basis through brokers who are members of local real estate boards in medium- to large-sized metropolitan areas around the nation.

When the Panel was first established, executive officers (EOs) of more than 440 boards located in Census A and B strata Metropolitan Statistical Areas (MSAs) were asked to submit the names of expert residential brokers who would be willing to participate in a regularly reporting survey panel. Currently, the panel consists of about 2,000 brokers, representing virtually all of the 440 boards and three times each year, they are sent a questionnaire requesting financing information on their two most recent residential closings. The response rate from individual brokers tends to be in the 22 to 25 percent range, with almost all respondents providing the requested two transactions. Approximately 425 to 450 responses are received in the one month period after the questionnaire is mailed, usually totaling about 850 transactions. This is a very good response rate for a mail-out panel, particularly because this questionnaire asks for detailed information that can only be obtained by referring to broker file records.

TABLE 1

Contract and Effective Interest Rates on FRMs and ARMs and Percent Adjustables: Conventional Loans Closed—Selected Months, 1982-1985 (Percentages)

	Fixed-Rate Mortgages		Adjustable Rate Mortgages		
Year/ Month	Contract Rate (%)	Effective Rate (%)	Contract Rate (%)	Effective Rate (%)	Percent of Loans with Adjustable Rates
1982					
July	14.95	15.53	15.08	15.69	43
August	14.98	15.55	15.18	15.76	46
September	14.67	15.19	14.58	15.23	44
1983					
March	12.85	13.29	12.47	12.91	30
April	12.37	12.82	12.26	12.68	29
May	12.46	12.92	12.03	12.48	29
August	12.43	12.89	11.76	12.18	33
September	12.65	13.13	11.95	12.41	45
October	12.46	12.94	11.83	12.26	50
1984					
May	12.44	12.96	11.20	11.65	62
June	12.60	13.09	11.33	11.80	65
July	12.90	13.46	11.54	12.03	66
September	12.98	13.47	12.01	12.49	66
October	13.13	13.67	12.07	12.57	64
November	12.89	13.41	12.04	12.53	60
1985					
January	12.54	13.10	11.58	12.05	50
February	12.42	12.93	11.23	11.69	46
March	12.39	12.87	10.92	11.37	49
April	12.35	12.90	10.84	11.29	50
May	12.41	12.94	10.85	11.30	52
June	12.14	12.63	10.66	11.10	56
July	11.79	12.23	10.31	10.76	53
August	11.64	12.14	10.13	10.56	52
September	11.54	12.02	9.90	10.32	49
October	11.63	12.12	10.00	10.41	50
November	11.50	11.99	9.94	10.36	49
December	11.41	11.88	9.81	10.22	48

Source: Federal Home Loan Bank Board News, Selected releases.

> "The omnipresent factor driving the 1985 housing market was the steady decline in mortgage rates that began about the middle of the summer."

The most important contribution of the Panel is that it allows for in-depth cross-sectional examination of the mortgage financing techniques involved in home sale transactions. Also, it provides information on the financing used in actual home sales as opposed to the terms of lender offerings or commitments. Although the basic respondent frame is a "selected" sample (i.e., those brokers who were best known by EOs and willing to participate), the Panel seems to provide reasonable and consistent responses for most of the questions. Furthermore, the emphasis on the two most recent sales helps reduce any broker bias to provide information on favorite properties or instruments used to finance the purchase (i.e., "creaming" the sample).

The questionnaire allows brokers to report detailed information on the terms of up to three mortgage notes on a property, including the amount, interest rate and term to maturity. In addition, for the first two notes, the questionnaire requests information on instrument type, source/originator and type of insurance. In 1984, a detailed section on the features of ARM first mortgages was added because many ARM surveys focus only on lender offerings and, *a priori*, do not reflect which ARMs have actually been originated. There are also questions covering the basic characteristics of the property and the sociodemographic profile of the buyer and seller. In 1986, several additional questions on the structural characteristics of the dwelling unit are being asked.

Weakness in the other available data series

The FHLBB publishes information on loan terms on conventional fixed-rate and adjustable rate mortgages in the marketplace and is the most frequently quoted source of information on the percentage of conventional first mortgages that are ARMs. By design, the instruments and financing sources in the FHLBB survey do not include FHA-insured or VA-guaranteed mortgages. Furthermore, the data ignore loans that are not fully amortizing, so that balloon mortgages are excluded. On the sources side, assumptions are not counted in the survey unless a lender "originates" them by changing the name of the borrower on the loan note. Seller financing is obviously not included, although it has not been a substantial factor in the market during the past couple of years. Some analysts also believe that it tends to oversample savings and loan associations and undersample mortgage bankers. If this is the case, the FHLBB survey has a more narrowly defined base than is generally believed.

The HUD survey includes conventional, FHA-insured and VA-guaranteed loans but does not provide any information on seller originations, assumptions or the types of mortgage instruments used. Nevertheless, it is the most comprehensive publicly available series on the dollar volume of originations, purchases and mortgage sales. It is particularly useful for measuring the conventional and FHA/VA market and the volume of loans sold in secondary mortgage markets.

In 1985, the Panel data were collected during three periods covering late March to mid-April, late June to mid-July and late September to mid-October. The 1985 data base includes information on approximately 2,300 transactions. An analysis of the time trend of changes in mortgage sources and instruments is presented for the

TABLE 2

The Number of Mortgages Used in Home Financing (Distributions on the Percent of Transactions)

Mortgage(s)	Oct. 1985	Jul. 1985	Apr. 1985	Oct. 1984	Jun. 1984	Sept. 1983	Apr. 1983	Aug. 1982
First (only)	91	87	85	86	85	82	78	62
First and Second	5	7	9	9	9	10	11	20
First, Second and Third	*	*	*	*	1	1	2	3
Other (primarily cash sales)	4	6	6	5	5	7	9	15
	100	100	100	100	100	100	100	100

* Less than 1 percent.

TABLE 3

Trends in the Use of Various Types of Instruments

3(a)
First Mortgage Instruments
(Percentage Distributions on Instruments)

Instrument	Oct. 1985	Jul. 1985	Apr. 1985	Oct. 1984	Jun. 1984	Sept. 1983	Apr. 1983	Aug. 1982
Traditional, Fixed-Rate Mortgage (FRM)	74	68	68	55	54	63	76	52
Adjustable Rate Mortgage (ARM)	20	25	23	34	36	22	10	10
Graduated Payment Mortgage (GPM)	1	2	2	2	3	5	4	4
Land Contract	1	1	2	3	2	2	3	9
Wraparound Mortgage	1	*	*	1	*	1	*	2
Short-term Mortgage with Balloon Payment	2	2	3	4	3	5	4	10
Other**	1	2	2	1	2	2	3	13
	100	100	100	100	100	100	100	100

3(b)
Second Mortgage Instruments
(Percentage Distributions on Instruments)

Instrument	Oct. 1985	Jul. 1985	Apr. 1985	Oct. 1984	Jun. 1984	Sept. 1983	Apr. 1983	Aug. 1982
FRM	53	45	59	44	46	46	41	42
ARM	8	7	2	6	3	2	*	*
GPM	7	*	*	*	*	2	*	1
Land Contract	6	2	2	3	4	2	4	3
Wraparound	*	3	*	*	7	6	4	4
Balloon	23	35	32	43	37	37	50	42
Other**	3	8	5	4	3	5	1	8
	100	100	100	100	100	100	100	100

* Less than 1 percent.
** Includes equity participation mortgages.

> "Due to the uncertainty of future levels of mortgage interest rates, many of these ARMs may turn out to be better instruments in the long run."

three periods in 1985, as well as for several collection periods going back to August 1982.[6] Also, a detailed cross-sectional look at the 1985 sources and uses of various types of instruments is provided. However, for this analysis, the three periods in 1985 are combined into a single period to provide better overall estimates of the relative use of these instruments and sources.

The number of mortgages used in home financing

Since the summer of 1982, the use of just a single mortgage loan to finance a home purchase has been on the rise (See Table 2). During the housing recession, when interest rates on institutionally provided financing were in the 14 to 16 percent range, "creative" arrangements involving below-market second and third loans were used extensively to "blend" interest rates to help keep monthly mortgage payments down. The source of these loans was either an assumed existing lien or a newly originated loan from a seller who was "taking back" financing to facilitate the sale of his property at a higher price. At that time, junior mortgages were present in the financing packages in more than 20 percent of these sales. However, the decline of mortgage rates in early 1983 set the stage for a substantial change in the way future financing transactions would be structured.

By spring 1983, junior financing was present in less than 15 percent of sales and a single mortgage was used in more than eight out of ten home financing transactions. Due-on-sale enforcement by lenders had a major impact on assumptions. However, lender resistance to providing second liens or wraparound arrangements were also contributing factors. Furthermore, as mortgage money became more affordable, all cash arrangements declined in use to around 5 percent of all home sales. Throughout 1984 and into early 1985, second and third loans were involved only about 10 percent of the time, while single loan packages were used in about 85 percent of sales. In addition to the substantial decline in mortgage interest rates since last summer, the use of just a single loan in home financing is occurring in more than 90 percent of home purchases.

The use of first mortgage instruments

From summer 1982 to last fall, the relative use of traditional, level payment, fixed-rate mortgages increased 50 percent. In August 1982, FRMs were more than half of all first mortgage instruments and ARMs and short-term loans with balloon payments each held a 10 percent share. By late 1983, ARMs had doubled their market share to more than 20 percent of all firsts and they climbed to a peak share of more than one-third in mid- to late-1984 [See Table 3(a)].

By mid-year 1985, when effective rates on FRMs were still in the 12.1 to 12.6 percent range, ARMs accounted for 25 percent of all first loans. At that time, ARM effective rates averaged 10.5 to 11 percent. However, by early fall, effective rates on level payment, mortgage financing had fallen about 25 basis points to just below 12 percent and rates on adjustables had dropped about 35 basis points to about 10.4 percent. Although ARM rates actually fell further than those on FRMs during this period, they still lost market share to traditional "plain vanilla" loans.

The Federal Home Loan Bank Board figures for 1985 show ARMs at nearly 50 percent of conventional originations in early 1985. According to the FHLBB, this figure rose to 56 percent in June and then steadily declined to just below 50 percent by the end of the year. Of course, the base of this ratio is the number of conventional, first loans originated by the four major types of institutional lenders.

The base for the calculation of these market shares in the Panel data includes sellers and private investors as sources as well as FHA and VA loans, with the latter almost entirely the fixed-rate variety. Furthermore, the Panel provides information on nonfully amortizing loans such as balloons and graduated payment mortgages (GPMs). One explanation for the seemingly low Panel estimates of the percent of loans that are ARMs is the larger base of the calculation. This difference will be explored further in the cross-sectional examination of the results for 1985.

The use of second mortgage instruments

The Panel data show that the relative use of fixed-rate second mortgages has steadily increased since late 1982, although this has been primarily at the expense of balloon loan financing.[7] Interestingly, ARMs have gradually increased in use as a second instrument but there has been significant fluctuation in the relative use of the other loan types.

In the seconds market, the major competitor to the FRM has been the short-term balloon mortgage. Frequently, this type of instrument is used as a fixed-rate interest-only loan with the outstanding principal due at the end of a 3- to 5-year period. However, some balloon loans involve partial amortization as well. By the end of the summer 1982, FRMs and balloon loans held equal shares of the seconds market—each at 42 percent. However, by early 1983, the balloon loan became the dominant second mortgage instrument, reaching the apex of its share at 50 percent. Although balloons seemed to hold about 40 percent of the seconds market from late 1983 through fall 1984, by early 1985, their share dropped to about one-third. There was also a further drop to below 25 percent by fall 1985.

From late 1983 through 1984, traditional fully amortizing loans were the dominant instrument, holding about 45 percent of the seconds market.

continued

During that period, the most important reason for the increased share of FRMs was the easing in mortgage interest rates. These rate declines reduced the need for the below-market financing that sellers had been offering in the early 1980s.

Paralleling the trend for first mortgages, was an even stronger shift in favor of traditional fixed-rate financing. While ARM second loans reached a peak at just below 10 percent, in 1985, there was a substantially decreased use of most other types of instruments with junior financing. Clearly, there are not many below-market "creative" balloon seconds currently being originated. Furthermore, the most recent declines in mortgage rates ensure that the spring 1986 market should see an even larger increase in single-loan packages with FRMs.

However, the 1985 Panel data showed substantial divergence from this trend for two important types of second mortgage instruments. GPMs, which seemed to be virtually nonexistent since mid-1984, suddenly increased in use in late 1985. A similar phenomenon occurred with land contracts. Certainly, the gradually declining interest rates and the growth in ARMs during the last couple of years account for the decline in GPMs, but the reason for the sudden increase in late 1985 is not clear at all. One suspects, however, that there probably have been some undermeasurement problems during the past couple of years associated with GPMs. Some "true" GPMs may have actually been confused with ARMs in the past or they could have been graduated payment ARMs (GPARMs) that were classified as ARMs.

Historically, land contracts have been used extensively in the upper Midwest. Perhaps the worsening agricultural recession and perceived higher financial risks in that region account for their recent increased use as second mortgage instruments.

Sources of first mortgage loans

Since the end of 1982, there have been some dramatic shifts in the sources of mortgage loans. At the end of summer 1982, financial institutions accounted for only one in three firsts while assumptions were more than 40 percent of the market [Table 4(a)]. Furthermore, during this period, home sellers originated a substantial share of first loans amounting to nearly 20 percent of the market. However, the substantial drop in rates at the end of 1982 caused a doubling in the share for financial institutions, while tougher due-on-sale enforcement by thrifts lowered the use of assumptions to just more than 20 percent of first mortgages. The improved interest rate environment in 1983 also substantially reduced the willingness of sellers to originate loans.

TABLE 4

Trends in the Sources of Mortgage Loans

4(a)
First Mortgage Loans
(Percentage Distributions on Sources)

Source	Oct. 1985	Jul. 1985	Apr. 1985	Oct. 1984	Jun. 1984	Sept. 1983	Apr. 1983	Aug. 1982
Commercial Banks	10	11	10	10	7	9	10	8
Thrifts**	26	30	27	30	28	30	23	13
Mortgage Bankers	45	42	40	32	39	27	29	12
Assumptions	9	10	15	18	17	22	22	41
Sellers	4	4	5	8	6	8	10	18
Other***	6	3	3	2	3	4	7	8
	100	100	100	100	100	100	100	100

4(b)
Second Mortgage Loans
(Percentage Distributions on Sources)

Source	Oct. 1985	Jul. 1985	Apr. 1985	Oct. 1984	Jun. 1984	Sept. 1983	Apr. 1983	Aug. 1982
Commercial Banks	10	5	8	12	5	9	2	4
Thrifts	5	7	8	15	10	9	9	7
Mortgage Bankers	8	8	10	9	12	8	9	9
Assumptions	*	4	2	4	6	7	10	11
Sellers	71	64	58	55	56	57	58	65
Other***	6	12	14	5	15	10	12	4
	100	100	100	100	100	100	100	100

* Less than 1 percent.
** Savings and loan associations and mutual savings banks.
*** Includes private investors, friends, relatives, etc.

By early summer 1984, when rates on traditional mortgage loans were moderately higher than they were at the end of 1983, adjustables were marketed at contract rates that were about 130 basis points below those on traditional, 30-year loans. Thus, institutions were actually able to increase their relative market share to just under three-fourths of all first mortgages used in home financing. Furthermore, during this period, assumptions declined to under 20 percent of the market due to the combination of due-on-sale enforcement and the initial interest rate attractiveness of many ARM offerings. In response to these factors, the share of firsts for sellers also tended to drop slightly during the same time frame.

The early spring market in 1985 saw effective interest rates on institutional FRMs holding at about the same level that they were the year before. Effective rates on ARMs were about 25 to 50 basis points below what they were a year earlier. However, from the middle of the summer, mortgage rates for both types of instruments fell steadily throughout the remainder of 1985 and this decline continued well into 1986. During this period, financial institutions pushed their share of firsts to exceed 80 percent of the market, while assumptions and sellers declined to half the proportion that they held at the end of 1984.

The Panel data show that commercial banks provided a relatively constant 10 percent of first mortgage loans during the last three years, while the share from thrifts has ranged from 13 to around 30 percent. These data also identify significant fluctuations in the market share of firsts from mortgage bankers—a figure varying from 27 percent in late 1983 and 45 percent by late 1985. Since 1985, mortgage bankers have been the dominant provider of first mortgage loans in the Panel samples, while the HUD figures have usually shown thrifts holding a larger share of loan volume than mortgage bankers.

Sources of second mortgage loans

Currently, second mortgages are not frequently used in home financing transactions. However, they were used in about one in four home sales in late 1982. In 1984 and 1985, they were used, at most, in about one in ten sales.

TABLE 5

Joint Distribution of First Mortgage Instruments and Sources: Combined 1985 Sample Periods (Percentages)

	Instrument							
Source	FRM	ARM	GPM	Land Contract	Wrap	Balloon	Other**	Total Sources
Commercial Bank	6	3	*	*	0	*	*	10
Thrift	16	10	*	*	0	*	*	27
Mortgage Banker	33	8	1	0	*	0	*	42
Assumption	10	1	*	0	*	*	1	12
Seller	2	*	*	1	*	1	0	5
Other***	3	*	*	*	*	*	*	4
Total Instruments	70	22	2	1	1	2	2	100

* Less than one percent.
** Includes equity participation loans and other nonstandard instruments.
*** Includes private investors, friends, relatives, etc.

Traditionally, home sellers have originated 50 to 65 percent of second loans, with financial institutions accounting for about 25 percent of the market [Table 4(b)]. When an existing mortgage note that was originally made by an institution is assumed, the terms of the loan usually require it to become the first lien on the property. Because of this requirement, we can expect a low relative percentage share of assumptions as second loans. Although there has been some variation in this share, it has never exceeded 11 percent in the Panel surveys. In late 1985, sellers were supplying more than 70 percent of second loans but financial institutions provided just more than 20 percent. This very high percentage for sellers seems to deviate somewhat from the established trend and could reflect some inaccuracies in reporting. However, the low frequency of two and three loan packages leads us to suspect that this large percentage for sellers is most likely due to small sample bias.

In 1985, on average, mortgage companies (next to sellers) were the second most frequently used source of second loans. However, the institutional share of seconds has varied substantially during the past three years. Mortgage bankers have consistently supplied 8 to 10 percent of all seconds during the past three years while thrifts have supplied 5 to 10 percent of these loans. At the end of 1982 and in early 1983, commercial banks were supplying from 4 to 9 percent of all second loans but their share was in the 5 to 10 percent range during the past year.

The following analysis focuses exclusively on the 1985 Panel data, combining the responses for the March/April, June/July and September/October periods into a single data base. By combining the three periods, the sample exceeds 2,300 home sales (guaranteeing at least 2,200 first mortgages) and provides a more accurate statistical picture of the sources and instruments used in the marketplace during the past year. However, because second mortgages were used in only about 7 percent of all transactions, this

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group is too small for meaningful cross-sectional examination. As a result, the focus is further narrowed to instruments and sources of first mortgage loans. Table 5 provides a joint frequency distribution of the sources of loans and the instruments used for the three combined periods. This joint distribution allows determination of the relative origination sources for first mortgage instruments.

Proportionally, mortgage bankers appeared to be the primary source of first mortgage loans, contributing more than 40 percent of the entire market. Mortgage bankers contributed almost one-half of all FRMs (47 percent) and more than one-third of all ARMs (36 percent). ARMs accounted for about 20 percent of all mortgage banker originations in 1985. Thrifts contributed more than one-fourth of all loans but they provided only half as many fixed-rates as mortgage companies (23 percent). Overall, thrifts were more likely to provide ARMs than were mortgage companies, supplying 45 percent of all adjustables. ARMs accounted for just under 40 percent of all thrift first loan originations. The FHLBB data for the panel months in 1985 (See Table 1) indicate that ARM loans averaged 50 to 55 percent of conventional firsts from institutions. The Panel estimate indicates that they were only about 28 percent of institutional originations of FRMs and ARMs (21 percent of 79 percent).

In 1985, commercial banks accounted for only about 10 percent of all first mortgages with a roughly two-to-one split between fixed-rate loans and ARMs. Interestingly, assumptions accounted for about 12 percent of firsts (larger than the commercial bank share) and, not surprisingly, almost all were of the fixed-rate variety. Sellers only provided 5 percent of first mortgages in 1985 and a majority of them were in the form of either fixed-rate fully amortizing loans, land contracts or balloon loans.

Mortgage instruments and loan sources by market segments

In analyzing these markets, it is interesting to examine the relative sources of loans and uses of instruments by various segments of the market. The segments to be examined include conventional loans (no Federal Housing Administration (FHA) or Veterans Administration (VA) loans included), new conventional loans (no FHA, VA or assumptions included), new conventionals from institutions (no sellers or "others" included) and FHA-insured and VA-guaranteed loans as a separate market segment. Performing this type of analysis is useful in order to examine how the base of the comparison affects the measurement of the relative use of a particular type of instrument or source. Table 6 provides a breakdown of the data by the specified submarket segments. The most important results for these submarkets are:

- *Conventional Loans*—FRMs accounted for more than 60 percent of these loans while ARMs made up about 30 percent of the market. GPMs and balloon instruments contributed an additional 5 percent.
- *New Conventional Loans*—Because a large proportion of assumptions were FHA or VA loans, there was virtually no difference between the results for all conventionals and new conventionals.

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TABLE 6

First Mortgage Instruments Used in 1985: All Loans, Conventional and FHA/VA Submarkets (Percentage Distributions)

Instruments	All Loans	Conventional All Sources	Conventional New Originations	Conventional New from Institutions	FHA/VA Only
FRM	70	61	59	61	94
ARM	22	30	32	35	1
GPM	2	2	2	1	2
Land Contract	1	2	2	*	0
Wraparound	1	*	1	*	1
Balloon	2	3	3	1	0
Other	2	2	1	2	2
	100	100	100	100	100

* Less than 1 percent.

TABLE 7

Joint Distribution of First Mortgage Instruments: New Originations from Financial Institutions in 1985 (Percentages)

Instrument	Thrifts	Mortgage Bankers	Commercial Banks	Total Instruments
FRM	25	26	10	61
ARM	18	13	4	35
GPM	*	1	*	1
Other**	1	1	1	3
Total Sources	44	41	15	100

* Less than 1 percent.
** Includes land contracts, wraparounds, balloons, etc.

- *FHA/VA Loans*—As would be expected, FRMs accounted for almost 95 percent of FHA/VA loans. GPMs, the second most frequently used instrument, contributed 2 percent of FHA/VA firsts. The Panel data indicate ARMs (i.e., the FHA ARM) were only about 1 percent of firsts. This seems reasonable given the difficulties in achieving volume in the FHA ARM program.
- *New Conventionals from Institutions*—For this segment, FRMs were just more than 60 percent and ARMs accounted for 35 percent of the market. Table 7 provides a further breakdown for the three classes of institutional originators: thrifts, mortgage bankers and commercial banks. Thrifts accounted for 44 percent of new conventionals and mortgage bankers contributed 41 percent. Although both thrifts and mortgage bankers seem to be contributing the same relative proportion of FRMs, the former originated roughly half of all new conventional ARMs. Mortgage bankers contributed more than one-third of that market.

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Examining new conventional firsts from financial institutions, the Panel data indicate that ARMs were between one-third and 40 percent of the 1985 market. This figure is significantly below the average of the FHLBB monthly estimates. The FHLBB figures for the 1986 spring months showed this percentage to be dropping to below 30 percent, causing some lenders to vary the fees and loan amounts on adjustables to make them more attractive.[8] However, assuming the sample is more heavily weighted toward thrifts than mortgage bankers (and a few very large mortgage bankers), it is quite possible that the "true" ARM market share for conventionals from all institutions was closer to 40 percent in 1985. While the Panel data probably contain some classification errors with regard to the institutional source, these results strongly indicate that ARM loans accounted for considerably less than one-half of new conventional originations in the marketplace. Because traditional fixed-rate loans have clearly been the dominant instrument during the past two years, the continuing fall in long-term rates

TABLE 8

Sources of First Mortgage Instruments in 1985: All Loans, Conventional and FHA/VA Submarkets (Percentage Distributions)

		Conventional			
Source	All Loans	All Sources	New Originations	New from Institutions	FHA/VA Only
Commercial Bank	10	13	14	16	2
Thrift	27	35	39	44	7
Mortgage Banker	42	32	36	40	70
Assumption	12	10	NA	NA	18
Seller	5	6	7	NA	NA
Other*	4	4	4	NA	3
	100	100	100	100	100

* Includes private investors, friends, relatives, etc. NA: Not appropriate

TABLE 9

Joint Distribution of FHA and VA First Mortgage Instruments and Sources in 1985 (Percentages)

Source	FRM	ARM	GPM	Other***	Total Sources
Commercial Bank	1	1	0	0	2
Thrift	6	1	*	1	8
Mortgage Banker	66	*	2	1	69
Assumption	17	0	*	1	18
Other**	3	0	0	*	3
Total Instruments	93	2	2	3	100

* Less than 1 percent.
** Sellers and individual private investors cannot originate FHA or VA loans.
*** This category indicates some loans have been misclassified because FHA loans are either FRMs, ARMs or GPMs. VA loans are usually always FRMs, although there are programs for GPMs and growing equity loans (GEMs). VA loan volume in the latter two areas has been less than 1 percent during the past year.

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will probably enhance its share for the 1986 market. Even ARM contract rate quotes in the mid-7 to 8 percent range, which were present last spring, probably will not significantly slow the trend toward growth in FRM market share.

The FHA and VA market—sources and instruments

While thrifts are the primary source of conventional ARMs, mortgage bankers are the overwhelmingly largest provider of FHA-insured and VA-guaranteed first mortgage loans. Table 9 aptly demonstrates this through a joint frequency distribution for instruments and sources of FHA and VA loans. Overall, the Panel figures show that mortgage bankers originated almost 70 percent of FHA and VA loans in 1985, while thrifts originated under 10 percent. However, the thrift figure is probably slightly underestimated and the mortgage banker proportion is probably overestimated. According to the Panel figures, assumptions of fixed-rate loans accounted for below 20 percent of 1985 FHA and VA first mortgages, while ARMs and GPMs were each about two percent of this market. This table also shows that more than 3 percent of the respondents misclassified FHA or VA first mortgages as "other" types of instruments.

The Residential Mortgage Finance Panel data are a useful source of information for detailed analyses of the characteristics of mortgage instruments and their sources, as well as information on the homebuyers and their properties. The data base can provide a reasonably accurate, timely and consistent "micro" view of mortgage financing techniques used in home sales.

While there are some minor inconsistencies and misclassification problems associated with selected subgroups of the data, careful editing of the survey questionnaires can minimize these problems. Compared to other sources, the data base may tend to underrepresent thrifts. However, bench marking with other data sources may help to correct any inaccuracies in the future.

N.A.R. is making this data available (on IBM compatible floppy diskettes) to the public for a moderate fee. Any suggestions, comments or inquiries are welcome and can be directed to: Frederick E. Flick, N.A.R., 777 14th St. N.W., Washington, D.C. ☐

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1. Estimates of these mortgage terms for the first week of a prior month are published within the first week of the month in *Federal Home Loan Bank Board News*. These figures for 1982-1984 are presented in three-month groupings around the month in which a NAR mortgage finance survey was fielded. Because rates on loans closed during a period are often based on prior month commitments, it is useful to refer to the prior month rate to explain current month market rates.
2. Published monthly, quarterly and annually as the "Survey of Mortgage Lending Activity," a news release from the Office of Public Affairs of the U.S. Department of Housing and Urban Development.
3. See *Residential Finance*, HC80-5, 1980 Census of Housing, Volume 5, Bureau of the Census, U.S. Department of Commerce, November 1983.
4. The bond market research department at Salomon Brothers Inc. publishes the *Biweekly Mortgage Market Roundup*, as well as specific reports covering mortgage prepayments, developments in housing and mortgage finance, rate of return indexes and various aspects of mortgage securities and securitization. The mortgage securities unit at Shearson Lehman Brothers, Inc. publishes *Mortgage Finance Marketplace* on a monthly basis, as well as specialized publications on topics dealing with mortgage securities.
5. Fannie Mae and Freddie Mac routinely publish information on the volume of loans purchased, securities issued, primary and secondary market rates and yields and related operational data. Freddie Mac also publishes research and analysis through its monthly *Freddie Mac Reports* and the *Secondary Mortgage Markets* quarterly.
6. Prior to 1984, similar data was collected from random samples of the membership as a special mortgage finance survey and as part of biennual surveys of member attitudes on policy issues and NAR programs. The number of responses from these surveys was roughly equivalent to that of the Panel, however, mailings to randomly selected members were typically in the 5,000 to 7,000 range.
7. These second mortgage loans were originated for the purpose of purchasing property, not to access existing home equity for consumer purchases.
8. Kathleen A. Hughes, "Banks Cut Fees on ARM Loans As Appeal Fades," *The Wall Street Journal*, April 4, 1986, p. 23.

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MORTGAGE MARKET TRENDS

Recent economic news continues to demonstrate weakness in the industrial sector. Nonfarm payroll employment increased only 150,000 in May, as further substantial job losses occurred in both manufacturing and mining. Industrial production was down 0.6 percent in May 1986, with declines widespread by category of output.

The weakness in the industrial sector stems from three principal sources—reductions in output to bring inventories into better balance with sales, particularly in the auto industry; sharp further declines in oil and gas drilling activity and relatively soft markets for some categories of business equipment, especially computers and related equipment.

In contrast to developments in the industrial sector, residential construction is exhibiting exceptional strength. Housing starts in May declined 7½ percent to an annual rate of 1.9 million units. The decline was entirely in multifamily structures and may reflect the negative effects of expected passage of a tax reform bill. Nonetheless, total housing starts in May were 11½ percent above a year earlier and anecdotal evidence suggests that single-family homes are still being purchased faster than they can be built.

Consumer spending is also relatively strong. Real personal consumption expenditures rose at nearly a 4 percent annual rate in the first quarter and increased further in April. In May, unit auto sales increased and real retail sales outside of autos probably held close to their April levels. MBA believes real personal consumption expenditures in the second quarter will show another increase of 4 percent or more at an annual rate.

These elements of strength in residential construction and consumer spending will tend to offset the decline occurring in the second quarter in inventory investment and oil drilling activity. Nevertheless, real GNP growth this quarter will probably be around a 2 to 2½ percent annual rate, below the downward-revised 2.9 percent figure of the first quarter.

The producers price index for May rose 0.6 percent—the first increase for any month this year. Rising prices of food and energy were principally responsible. Energy price declines are now largely behind us and food prices have risen because of drought conditions in some of the fruit- and vegetable-growing areas of the country. Outside of food and energy, the increase was just 0.2 percent, about the same as the average monthly rise during the first four months of the year.

The inflation fundamentals, however, still look quite good. Markets for labor and products are still very competitive; wage rate increases are not getting larger and businesses encounter buyer resistance when they seek to widen profit margins by raising prices. Productivity growth is still poor but MBA sees no evidence that the trend of cost increases—which is the basic determinant of prices—has begun to worsen.

The markets for fixed-income securities have recently begun to display a better tone, following nearly two months of apprehension and substantial volatility of bond prices and yields. Weakness in the industrial sector has quieted concerns that the Federal Reserve might soon be moving toward a less accommodative posture of monetary policy.

Forecasts for the second half are now being revised downward by many forecasters. The evident weakness in the industrial sector has raised questions about the strength of the underlying expansive forces. MBA shares these concerns. Nevertheless, MBA believes that a pickup in the annual rate of economic growth to the 3½ to 4 percent range is likely in the second half. The strength of consumer demand in the second quarter should eliminate fairly soon the overhang of unwanted inventories, so that nonfarm inventory investment should turn up in the second half. Net exports, in real terms, should also improve modestly as the year goes on and the boom in single-family housing is expected to continue as a major source of strength. Business fixed investment will continue to be weak, but an end to the steep fall of oil drilling activity should permit a modest increase in this key sector of the economy during the second half.

As noted earlier, the anti-inflationary benefits of falling oil prices are waning. Also, rising import prices are now beginning to influence the domestic inflation rate. Therefore, a return of consumer price inflation to the 4 percent range is likely by late this year, but it would not signal any basic worsening of underlying inflationary forces.

For some time, MBA has been expecting only a moderate rise in interest rates as the economy picks up later this year. Belief in that forecast has been strengthened by the high probability that tax reform will pass. Both the Senate and House bills would reduce incentives to invest significantly, thereby tending to hold down the cyclical rise in interest rates that would otherwise occur.

Indeed, speculation has developed recently that another discount rate cut may soon be forthcoming. The Federal Reserve may be reluctant to take such a step unless at least one other large industrial country goes along. Japan is the most logical candidate. MBA would not be surprised to see a cut in the Bank of Japan's discount rate during the next few weeks followed by a similar action in the U.S.

Lyle E. Gramley
Chief Economist
June 19, 1986

HOUSING ACTIVITY
RESIDENTIAL STRUCTURES, BY UNIT TYPE
(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
NOV	125	80	45	1,654	1,082	572	120	74	47	1,668	1,039	629
DEC	115	71	44	1,882	1,181	701	128	68	60	1,839	1,077	762
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,861	1,187	674
FEB	107	71	36	2,001	1,317	684	684	68	41	1,808	1,155	653
MAR	149	103	46	1,930	1,289	641	152	99	53	1,834	1,150	684
APRp	188	129	59	2,009	1,346	663	180	125	55	1,883	1,256	[illegible]
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
4 MONTHS												
1986	560	382	178				561	365	196			
1985	521	354	167				518	331	186			
1984	546	384	162				558	362	196			
1983	458	327	131				452	298	154			

RESIDENTIAL STRUCTURES BY REGION
(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
NOV	20	17	57	30	235	210	767	442	21	16	52	32	268	206	725	469
DEC	17	13	57	34	283	261	870	468	19	17	62	30	263	271	844	461
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	290	314	767	490
FEB	13	11	51	33	404	370	745	482	12	12	53	32	287	306	743	472
MAR	20	21	69	39	326	338	753	503	21	20	64	46	276	287	718	553
APRp	30	32	79	50	329	358	802	520	29	32	69	48	303	326	721	[illegible]
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
4 MONTHS																
1986	76	73	258	152					76	76	247	162				
1985	59	54	261	148					70	55	243	150				
1984	44	56	303	146					51	57	293	157				
1983	40	45	274	100					39	43	266	104				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
NOV	246	51	357	6.0	$205.1	$86.0	$29.2	$89.9	1,087	627	460	143	100	43
DEC	219	47	350	5.7	210.4	86.6	29.9	93.9	1,089	618	471	162	113	49
1986														
JAN	213	54	351	6.0	211.2	89.0	29.7	92.5	1,094	628	466	122	81	41
FEB	218	59	345	5.9	214.2	92.1	29.8	92.3	1,110	638	472	118	76	42
MAR	280	87	334	4.7	210.3	91.9	30.9	87.5	1,100	627	473	134	93	41
APR	NA	81	334	4.7	213.3	94.4	32.6	86.3	1,134	641	493	129	95	34
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
4 MONTHS														
1986	*711	282										503	345	158
1985	645	231										492	338	154
1984	643	234										468	322	146
1983	555	206										338	247	91

*3 Month Totals

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$33,017	$5,869	$12,665	$12,370	$2,113	$21,151	$5,286	$9,551	$6,232	$82
JUL	31,407	6,503	11,709	11,051	2,144	21,273	5,969	9,093	6,110	101
AUG	34,928	7,792	13,324	11,832	1,980	25,518	7,028	10,996	7,390	104
SEP	35,188	7,422	13,316	12,346	2,104	24,104	6,963	10,483	6,541	117
OCT	36,525	6,548	14,014	13,288	2,675	24,450	6,104	11,032	7,208	106
NOV	32,964	5,060	12,363	11,888	2,966	21,142	5,300	9,367	[illegible]	[illegible]
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983 TOTAL	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
11 MONTHS										
1985	325,757	62,335	129,453	111,684	22,285	218,660	57,500	99,185	61,062	913
1984	266,922	46,279	118,863	88,361	13,419	183,239	43,384	89,273	49,836	746
1983	247,709	57,539	93,329	84,040	12,801	180,773	54,164	74,083	51,902	624
1982	113,112	26,175	36,990	43,139	6,808	79,226	23,759	30,005	24,986	476

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$2,519	$418	$1,417	$590	$94	$9,347	$165	$1,697	$5,548	$1,937
JUL	1,804	53	974	604	173	8,330	481	1,642	4,337	1,870
AUG	2,201	239	1,085	665	212	7,209	525	1,243	3,777	1,664
SEP	2,202	287	1,099	656	160	8,882	172	1,734	5,149	1,827
OCT	2,694	150	1,456	700	388	9,381	294	1,526	5,380	2,181
NOVp	2,585	183	1,401	756	245	9,137	277	1,605	4,639	2,616
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983 TOTAL	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
11 MONTHS										
1985	22,986	2,122	12,669	6,151	2,044	84,111	2,713	17,599	44,471	19,328
1984	18,138	401	11,672	5,031	1,034	65,545	2,494	17,918	33,494	11,639
1983	14,036	553	7,525	4,660	1,298	52,900	2,822	11,721	27,478	10,879
1982	5,761	901	2,566	1,929	365	28,125	1,515	4,419	16,224	5,967

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$28,091	$5,731	$14,174	$5,385	$2,801	$105,354	$13,116	$56,079	$19,126	$17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,706	14,684	49,838	17,882	17,302
AUG	32,123	6,588	16,969	5,434	3,132	103,290	14,190	50,198	20,243	18,659
SEP	30,531	6,123	16,055	6,094	2,504	114,357	15,205	50,579	29,268	18,980
OCT	29,039	4,208	16,134	5,775	2,922	110,307	12,436	49,882	29,100	18,889
NOVp	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
1984 TOTAL	249,401	70,128	146,184	47,065	20,844					
1983 TOTAL	258,986	44,893	123,361	38,195	17,717					
11 MONTHS										
1985	295,373	53,497	155,874	56,741	29,261					
1984	238,436	41,090	135,312	43,255	18,779					
1983	229,963	65,006	113,345	35,210	16,402					
1982	100,892	37,572	39,102	17,483	6,735					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1985												
NOV	173	78	27	68	128	$8,488	47	$2,795	25	$1,693	56	$4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	305	211	33	61	115	7,752	57	3,477	23	1,621	35	2,654
APRp	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
4 MONTHS												
1986	1,100	747	114	239	428	28,999	195	11,849	78	5,466	155	11,684
1985	635	247	64	324	367	23,687	92	5,215	51	3,360	224	15,112
1984	631	172	75	384	448	28,302	85	4,535	86	5,309	277	18,458
1983	627	305	116	206	292	17,303	94	4,808	65	4,025	133	8,470

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA Portfolio Comm.	FNMA Portfolio Purc.	FNMA Mortgage-Backed Securities Outstanding	FNMA Mortgage-Backed Securities Issued	FHLMC Comm. to Sell	FHLMC Comm. to Buy	FHLMC Mtg. Purc.	FHLMC Mtg. Sold	GNMA Pass-Through Securities Applications	GNMA Pass-Through Securities Issued
1985										
NOV	$1,199 \	$1,624	$52,198	$2,469	$5,394	$4,854	$3,681	$3,449	$6,059	$5,251
DEC	1,858	1,663	54,987	3,365	3,076	3,425	6,095	6,335	5,699	4,520
1986										
JAN	1,315	1,188	58,391	3,964	4,880	5,273	3,709	3,300	10,103	5,298
FEB	2,578	1,159	60,752	2,978	5,526	6,044	4,605	4,268	5,973	5,006
MAR	1,917	1,410	62,310	2,260	7,213	7,128	5,318	5,900	14,853	5,059
APRp	3,774	1,631	64,171	2,835	NA	NA	NA	NA	13,336	6,900
1985 TOTAL	20,225	21,510	—	23,649	30.743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
4 MONTHS										
1986	9,584	5,388	—	12,037	*17,619	*18,477	*13,632	*13,468	44,265	22,466
1985	6,751	7,273	—	5,676	9,972	11,339	8,676	7,523	14,742	10,684
1984	6,889	6,597	—	4,284	4,650	4,729	4,098	3,184	12,266	10,217
1983	4,998	6,076	—	5,131	4,260	4,365	6,016	5,866	24,818	15,881

*3 Month Totals

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES FHA OPINION SURVEY FHA NEW[4]	FHA OPINION SURVEY CONVENTIONAL New	FHA OPINION SURVEY CONVENTIONAL Existing	FHLBB SURVEY CONVENTIONAL New	FHLBB SURVEY CONVENTIONAL Existing	FNMA 1 Yr. ARM (1%/Yr.)	FNMA FRM Conv.	APARTMENTS[5]
1985								
DEC	10.70%	11.03%	11.03%	10.94%	11.12%	9.94%	10.425%	12.06%
1986								
JAN	10.78	10.82	10.93	10.89	10.81	10.00	10.375	12.00
FEB	10.59	10.49	10.50	10.68	10.83	9.89	10.269	11.63
MAR	9.77	10.06	10.10	10.50	10.62	9.04	9.494	11.09
APR	9.80	9.99	9.99	10.27	10.37	8.49	9.300	10.84
MAYp	NA	NA	NA	10.19	10.16	8.70	9.663	10.81

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS GNMA[6]	FNMA[6]	FHLMC[6]	SELECTED SECURITIES A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1985							
DEC	10.02%	NA	NA	10.91%	9.26%	7.14%	7.75%
1986							
JAN	9.99	10.18	10.22	10.74	9.19	7.16	7.71
FEB	9.75	9.90	9.95	10.21	8.70	7.11	7.63
MAR	9.05	9.23	9.27	9.41	7.78	6.57	7.20
APR	9.01	9.08	9.12	9.26	7.30	6.08	6.60
MAYp	9.33	NA	NA	9.50	7.71	6.19	6.63

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
DEC	(21)	76	NA	NA
1986				
JAN	4	80	99	103
FEB	38	105	120	125
MAR	36	127	145	149
APR	54	171	178	182
MAY	NA	162	NA	NA

NA—Not available, p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]	Total[2]	1-4 Units	5+ Units	Non-res.[3]
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,880	[illegible]	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-res.[3]	Total	1-4 Units	5+ Units	Non-res.[3]	1-4 Units	5+ Units	Non-res.[3]	1-4 Units	5+ Units	Non-res.[3]
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,810	80	960	7,850	100	750	7,810	260	1,370
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH		1-4 Units				5+ Units			
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	580

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4] 1-4 Units	5+ Units	Non-[3] res.	SERVICING VOLUME[1] Total	1-4 Units	5+ Units	Non.[3] res.	NOTES PAYABLE[1] (End of Month Balances) Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED Total	1-4 Units	5+ Units	Non-[3] res.	DISBURSEMENTS DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	END OF MONTH INVENTORY Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH Total	1-4 Units	5+ Units	Non-[3] res.	END OF MONTH BALANCES Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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MORTGAGE BANKING

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Dr. Victor Cholewicki

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MULTIFAMILY: FIRST CLASS SERVICING
Hunter Wolcott

Multifamily servicing buyers need to be even more skillful than single-family servicers because each loan is a crucial part of the overall investment. This article details differences between value of servicing and price.

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BUSINESS BASICS—DIALING FOR DOLLARS
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MGIC is currently providing a program where the goal is to produce a winning situation for borrowers, lenders and mortgage insurers. Telecounselors and field personnel try to work with borrowers to establish a repayment plan avoiding foreclosure and eventual insurance claims.

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PRIVATE CONDUITS: IT'S NOT JUST A JOB, IT'S AN ADVENTURE
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The third generation of private conduits is described in this article. Its mission will be to tailor products and programs that meet the originator's needs and then use securitization to create instruments that will be acceptable by institutional investors.

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EMPLOYEE TRAINING: MORE FOR YOUR MONEY
Laurie C. Sain

Practical training will enable employees to provide quality customer service. They will be capable of processing loans, answering questions and dealing with problems effectively. A case study of Guild Mortgage is presented in this article.

PAGE 80
THRIFTS: MOVING OUT OF THE STONE AGE
Peter E. Knight

Thrifts are changing their business tactics to meet new challenges. High interest rates and deregulation forced many S&Ls to shift from portfolio lending to mortgage operations in the early 1980s. Ironically, low interest rates and new regulations will encourage more to do so in 1986.

DEPARTMENTS

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DIGGING FOR GREATER SERVICING RETURNS

Servicing operations could be characterized by steady gains in servicing income, relatively stable unit costs of servicing and a rise in profit margins in 1984. However, there were some negative developments as well. Continued high delinquency and foreclosure rates caused a three-fold increase in net loss on foreclosures, a two-fold rise in provisions for loan losses and a sharp increase in the inventory of real estate owned (REO). Productivity, though higher than the relatively low level recorded in 1983, has still not regained its trend rate of the earlier 1980s. In addition, a large number of the most efficient firms in the previous year's survey reported significant declines in productivity in 1984 and accompanying increases in unit servicing costs.

The evolution of an active, well-functioning secondary market in servicing was a key development in the servicing area in 1984. Bulk servicing proved to be far more liquid than in previous years and traded very much like other financial assets. An estimated $80 billion in mortgage servicing changed hands as prices for high quality portfolios rose well above 2½ points in many cases. Government National Mortgage Association (Ginnie Mae) servicing, with relatively high servicing fees and a high degree of transferability, generally commanded the highest prices.

Dr. Victor Cholewicki

ILLUSTRATION BY DOUG KNUTSON

LOAN
SERVICIN

There were several reasons for the surge in the purchase of servicing in 1984. Many mortgage companies had embarked on a "wholesale" strategy in which acquisitions of bulk servicing played a key role. Depository institutions, who could employ servicing escrow balances to particularly good effect, became active acquirers of servicing. Nonfinancial firms, such as General Motors and Owens-Illinois, purchased sizeable mortgage companies, acquiring substantial servicing portfolios in the process. Such firms entered the mortgage banking industry to diversify their sources of income and to cross sell other product lines. Also, many firms both bought and sold bulk servicing during this period, largely to achieve a more efficient portfolio structure. The fact that purchased servicing can be treated as a depreciable asset that appears on the balance sheet proved an added inducement to purchase servicing.

Several factors contributed to the maintenance of supply on the secondary servicing market. Historically, high servicing prices encouraged sales of servicing portfolios. This induced many firms that had traditionally been aggressive accumulators of servicing to sell significant portions of their portfolios during this period. Also, the mid-1984 upturn in interest rates was regarded by many firms to be a transitory phenomenon and they retained their origination staff to position themselves for a subsequent resurgence in origination volume. Although this strategy proved to be correct, some firms found they had to offset their mid-year operating losses by selling servicing. Finally, some firms that incurred marketing losses during the period of rising interest rates sold servicing to maintain cash flow.

Dr. Victor Cholewicki is an economist for the Mortgage Bankers Association. He received his Ph.D. in economics from Brown University. Before joining MBA, Dr. Cholewicki served on the faculty at Boston University and at the Catholic University of America.

Typically, large scale transfers of servicing add significantly to the costs of the purchaser, especially in those cases in which adequate data bases were not included. For survey purposes, large transfers also caused some technical difficulties in the generation of realistic unit cost calculations.

Characteristics of servicing portfolios in 1984

Dollar servicing volume rose in 1984 by only 13.5 percent for surveyed firms. (See Table 1) This was the smallest percentage gain of the past six years surveyed and compares with a 25 percent gain in 1983. Even the low origination years of 1981 and 1982 produced larger percentage gains in dollar volume serviced.

This relatively low rate of growth in 1984 was due to a combination of reduced origination volume among mortgage bankers and a significant increase in the sale of bulk servicing. Relatively high mortgage rates especially around the middle of the year caused substantial declines in mortgage bankers' dollar volume of loans closed. Firms included in both the 1983 and 1984 surveys reported a 20 percent drop in dollar volume originated in 1984. Industry statistics from other sources confirm this sharp drop in origination volume.

Survey respondents added 85 cents worth of loans net to their servicing portfolio for each dollar they originated in 1984. This figure represents the ratio of the increase in the dollar volume of loans serviced to the dollar volume originated and is referred to as the servicing acquisition ratio. The 1984 servicing acquisition ratio of .85 was the lowest of the past six years.

Until 1983, the servicing acquisition ratio remained well over 1.0, indicating that most firms were adding more to their servicing portfolios than they were originating. In 1983, the servicing acquisition ratio fell to .94, largely due to heavy refinancing volume. (Firms refinancing a loan for which they already hold the servicing rights add to originations but not to servicing volume.) Another factor in the relatively low servicing acquisition ratio of 1983 was the relatively high volume of

TABLE 1

Portfolio Dynamics

	1984	1983	1982	1981	1980	1979
Rate of Growth of Dollar Vol. Svcd.	13.5%	25.0%	15.6%	17.4%	18.6%	25.9%
Servicing Acquisition* Ratio	0.85	0.94	1.24	1.65	1.20	1.08

*The ratio of the increase in dollar serviced to dollar originated

> **"Productivity, though higher than the unusually low level recorded in 1983, has still not regained its trend rate of the earlier 1980s."**

originations sold servicing released.

The low 1984 servicing acquisition ratio, on the other hand, was mainly due to a large volume of bulk sales of servicing; refinancings were relatively low in 1984. When mortgage banking firms are classified by type of ownership, only firms controlled by bank holding companies had a servicing acquisition ratio greater than 1 in 1984. They appear to have been net purchasers of servicing during this period.

Servicing Income in 1984

A solid 13 percent increase in servicing income per loan, together with a slight decline in net servicing expense and a moderate rise in the amortization of the cost of purchased servicing, resulted in a 29 percent increase in net servicing income to $79.22 in 1984. (See Table 2) Profit margin rose to 48.2 percent, compared with the unusually low 1983 figure of 42.4 percent. The return of profit margin to nearly 50 percent in 1984 is especially impressive in light of the large delinquency and foreclosure-related items of that year.

Servicing income per loan reached $164.35 in 1984, a 13 percent increase over 1983. (See Table 3) This increase was largely due to the rise in servicing fees to $138.12 per loan compared with the relatively low $123.23 figure of the prior year. (The low 1983 value was attributed to fee splitting, which was much less prevalent in the 1984 survey.) On the average loan size of $34,946, this trans-

TABLE 2

Income Statement: Servicing, Average Firm, 1983–1984

	1984	1983
INCOME:	Dollars per Loan	
Servicing Fees		
Servicing Fees, 1st Mortgage Loans	$137.81	$122.91
Servicing Fees, Non-1st Mortgage Loans	0.32	0.32
Net Gain Or Loss On Foreclosure	(4.99)	(1.75)
All Other Income		
Other Loan Administration Income	25.12	22.12
All Other Operating Income	6.09	1.32
Total Gross Servicing Income	$164.35	$144.92
EXPENSES:		
Personnel		
Loan Administration	$ 26.47	$ 27.18
Management not Classified Above	0.22	0.07
Directors	0.03	0.36
All Others	0.21	0.84
Employee Fringe Benefits	4.82	5.21
Occupancy	3.67	3.48
Electronic Data Processing	6.40	5.69
Other Direct Operating		
Equipment Rentals	1.30	1.30
Postage	1.86	2.20
Telephone and Telegraph	3.51	3.79
Office Supplies	2.10	2.60
Travel and Entertainment	0.69	0.76
Automobiles	0.21	0.35
Advertising	0.09	0.09
Legal and Auditing Fees	0.90	0.77
All Other Operating Expenses	8.30	8.52
Provision For Loan Losses	4.20	2.43
TOTAL NET SERVICING EXPENSE	$ 64.98	$ 65.65
Amortization Of The Cost Of Purch. Svcg.	$ 20.15	$ 17.88
NET SERVICING INCOME	$ 79.22	$ 61.39
Number of Firms	111	113

* Due to rounding, parts may not sum to totals.

TABLE 3

Servicing Income:

Income, per loan	1984	1983	1982	1981	1980	1979
Svc Fees	$138.13	$123.23	$118.06	$109.64	$104.19	$88.19
pct incr.	12.1	4.4	7.7	5.2	12.1	
Net Gain Fcl.	$(4.99)	$(1.75)	$(1.11)	$(.92)	$(.16)	$(.28)
pct. incr.	185.1	57.7	20.7	475.0	(42.8)	
All Oth. Inc.	$31.21	$23.44	$21.71	$17.27	$15.61	$13.37
pct. incr.	33.1	8.0	25.7	10.6	16.8	
Total Svc. Inc. per loan	$164.35	$144.92	$138.66	$125.99	$119.64	$101.28
pct. incr.	13.4	4.5	10.1	5.3	18.1	
Total Gross Svc Exp. per loan	$85.13	$83.53	$70.19	$58.68	$54.38	$46.29
Net Svc Income, per loan	$79.22	$61.39	$68.47	$67.31	$65.26	$55.00
Margin	48.2%	42.4%	49.4%	53.4%	54.5%	54.3%
Total Svc Income as Pct. Dollar Svcd.	.4703	.4413	.4628	.4546	.4603	.4488
Net Svc Inc as Pct Dollar Svcd.	.2267	.1869	.2313	.2429	.2516	.2437
Servicing Fee as pct. Dollar Serviced	.3943	.3752	.3988	.3956	.4018	.3908
Average Size Loan serviced	$34,946	$32,843	$29,604	$27,715	$25,933	$22.569

lates into a servicing fee as percent of dollar serviced of .3943. a level very near the trend of the 1979-1982 period.

Income in the *All Other Loan Administration* (See Table 2 for definitions) category rose 33 percent, to $31.21 per loan, in 1984 and contributed strongly to the overall servicing income increase. One of its components, *All Other Operating Income,* rose more than 300 percent, reflecting income received from the sale of servicing. This element of servicing income is more dependent on market conditions than on the day-to-day functioning of the servicing operation and can be expected to vary widely from year-to-year. An efficient firm might choose to sell servicing in a strong servicing market year and purchase in a weak year.

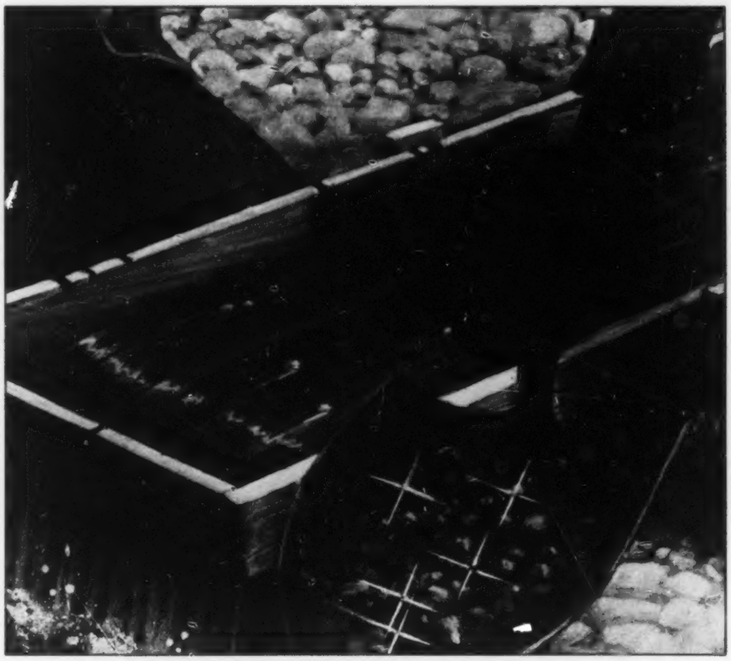
As noted earlier, there was a threefold jump in *Net Loss on Foreclosures.* (See Table 4) This item rose to $4.99 per loan compared with an already high loss level of $1.75 per loan recorded in 1983. Mortgage bankers have been particularly hard hit because they tend to service large numbers of Veterans Administration (VA) and Federal Housing Administration (FHA) loans, which have considerably higher delinquency and foreclosure rates than conventional loans. In addition, the foreclosure losses are generally larger on VA and FHA loans. More restrictive policies of the federal agencies have also raised servicers' losses; this is especially true of the VA's increasing use of its "no bid" option.

Servicers with relatively high average loan balances tend to incur high foreclosure losses. These firms typically hold servicing rights for a high percentage of two- to five-year-old loans in portfolio and foreclosure rates are higher for such loans.

Losses in this area can be expected to continue to grow until an improvement in delinquency and foreclosure rates occurs. Through the first quarter of 1986, this has not yet occurred.

Servicing expenses

Net servicing expense per loan declined to $64.98 from the $65.65 figure of the prior year. (See Table 5) Moderate loan administration personnel salary expenses, an increase in productivity and a decline in *Other Direct Operating Expenses* per loan were contributing factors to this improvement. The declines in personnel and *Other Direct Operating Expenses* per loan largely offset an almost twofold rise in *Provisions for Loan Losses* and increases in both occupancy and electronic data processing (EDP) costs per loan. The servicing expense ratio —servicing expenses minus the amortization of the cost of purchased servicing as a percent of the dollar volume serviced—fell to .1859 in 1984 from .1999 in 1983—after recording a string of four consecutive increases from 1980 to 1983.



Productivity increased 1.5 percent in 1984 as the number of loans serviced per servicing employee rose to 591 compared with the prior year's 582 figure. Until the upturn in 1984, productivity had been declining since 1981 when survey respondents reported 617 loans serviced per servicing employee, the highest level attained in the past six survey years.

Personnel expenses registered a 6 percent decline in 1984, falling to $31.75 per loan. (See Table 6) In a period of low inflation and wage restraint, salaries (excluding fringe benefits) of loan administration personnel increased a mere 2 percent in 1984 to $15,256. Cost reductions also occurred in the remaining servicing personnel categories and in fringe benefits.

Factors that determine personnel costs per loan, productivity and compensation vary by size of firm, type of ownership and geographical region. In terms of compensation, smaller firms, those with less than $300 million servicing portfolios, typically paid significantly higher average salaries than did larger firms. This is partly due to the fact that in small firms, loan administrators may be required to handle a wide range of functions. Privately held mortgage banking companies averaged loan administration salaries of $14,341, while for firms controlled by bank holding companies (BHCs), the figure was $14,794. Firms in the Other Controlled Subsidiary category (does not include firms controlled by savings and loan associations), on the other hand, averaged $16,055. Salaries (excluding fringe benefits) were highest in the West at $16,652 and lowest in the Northcentral region at $13,879. (See Table 8) Both the Northeast and the South were very close to the national average of $15,256.

Productivity, as measured by loans serviced per employee was also found to vary with size of firm and is also highly affected by the rate of growth of the servicing portfolio. Either negative or very high rates of growth adversely affect productivity and unit costs. Typically, large firms (more than $600 million in servicing) experiencing moderate growth (0 to 20 percent growth in dollar serviced) attained the best productivity results.

Interestingly, personnel costs, as a percent of total net servicing expenses, have been trending downward in recent years. Personnel expenses accounted for 56 percent of total net servicing expenses in 1980. By 1984, this figure was down to 49 percent.

The 5 percent rise in occupancy expenses per loan serviced in 1984, to $3.67, appears to be largely the result of an increase in rental rates. Occupancy expense per loan administration employee rose 10 percent in 1984 to $2,118.

Occupancy expense also tends to be a function of size of firm, type of ownership and geographical location. Large firms tend to use space efficiently. Firms controlled by BHCs average much lower occupancy expense per employee and per loan than other firms. Their occupancy expense per employee amounted to $1,777, which translates to $2.84 per loan. Other Controlled Subsidiaries incurred occupancy expenses of $2,623 per employee or $5.10 per loan. Occupancy expenses at privately held mortgage companies averaged $2,394 per employee and $4.73 per loan.

Geographical location also significantly affects occupancy costs. Both the Northeast and the West have occupancy expenses per employee well above the survey average, recording $2,416 and $2,337, respectively. Occupancy expenses in the Northcentral states averaged $1,633, while those in the South, at $2,154, fell very near the survey average.

The wide variety of possible data processing arrangements make for significant variances in EDP expenses. Firms may use a service bureau, purchase a system large enough for future, as well as present needs, use a related corporate entity's system in return for an allocation of the cost or own outright a system that has been fully depreciated. For many firms, a determination of the appropriate allocation of EDP expenses over profit centers is an exceedingly difficult task.

TABLE 4

Net Loss on Foreclosures and Provisions For Loan Losses, Per Loan

	1984	1983	1982	1981	1980	1979
Net Loss on Foreclosures	$4.99	$1.75	$1.11	$0.92	$0.16	$0.28
Pct. Incr. Over Prev. Year	185.1	57.7	20.6	475.0	(42.8)	
Provisions for Loan Losses P.L.	$4.20	$2.43	$(0.09)	$0.86	$0.48	$0.29
Pct. Incr. Over Prev. Year	72.8	...	...	79.2	65.5	

TABLE 5

Servicing Expenses Per Loan:

	1984	1983	1982	1981	1980	1979
EXPENSES PER LOAN:						
Personnel	$31.75	$33.66	$29.12	$26.41	$24.73	$22.28
pct. incr.	(5.7)	15.6	10.3	6.8	11.0	
Occupancy	$3.67	$3.48	$3.08	$2.83	$2.18	$1.91
pct. incr.	5.5	13.0	8.8	29.8	14.1	
EDP	$6.40	$5.69	$6.78	$5.57	$4.25	$5.03
pct. incr.	12.5	(16.1)	21.7	31.1	(15.5)	
Oth. Dir. Op.	$18.96	$20.39	$16.25	$12.44	$12.49	$10.54
pct. incr.	(7.0)	25.5	30.6	0.00	18.5	
Prov. Loan Loss	$4.20	$2.43	$(0.09)	$0.86	$0.48	$0.29
pct. incr.	72.8			79.2	65.5	
TOT NET SVC. EXP.	$64.98	$65.65	$55.14	$48.11	$44.13	$40.04
pct. incr.	(1.0)	19.1	14.6	9.0	10.2	
ACPC	$20.15	$17.88	$15.03	$10.58	$10.25	$6.25
TOTAL GROSS SVC. EXP.	$85.13	$83.33	$70.17	$58.69	$54.38	$46.29
Servicing Expense Ratio*	.1859	.1999	.1863	.1736	.1702	.1774
COMPONENTS						
PERCENT OF TOTAL NET SERVICING EXPENSES:						
Personnel	48.9	51.3	52.8	54.9	56.0	55.6
Occupancy	5.6	5.3	5.6	5.9	4.9	4.8
EDP	9.8	8.7	12.3	11.6	9.6	12.6
Oth. Dir. Op.	29.2	31.1	29.4	25.9	28.3	26.3
Prov. Loan Loss	6.5	3.7	0.0	1.8	1.1	0.7

*Net Servicing Expense as percent of Dollar Serviced

TABLE 6

Personnel

	1984	1983	1982	1981	1980	1979
Number of Loans Serviced per Servicing Employee	591	582	611	617	602	591
Pct. Incr. Over Prev. Yr.	1.5	(4.8)	(0.9)	2.5	1.8	
Average Salary, Loan Administration Personnel*	$15,256	$14,995	$13,575	$12,704	$12,202	$10,401
Pct. Incr. Over Prev. Yr.	1.7	10.5	6.9	4.1	17.3	
Total Personnel Expenses, per loan	$31.75	$33.66	$29.12	$26.41	$24.73	$22.28
Pct. Incr. Over Prev. Yr.	(5.7)	15.6	10.3	6.8	11.0	
Personnel Expense as Pct. of Dollar Serviced**	.0908	.1025	.0984	.0953	.0954	.0987
Personnel Expense as Percent of Net Servicing Expense	48.9	51.3	52.8	54.9	56.0	55.6

* Salary of Loan Administration Personnel only; also, excludes fringe benefits.
** Includes Compensation of Other Servicing Employees and fringe benefits.

TABLE 7

Income Statement: Servicing by Dollar Volume Serviced, 1984

	Less Than $300 Million	$300 to $600 Million	$600 Million to $1 Billion	$1 to $2 Billion	$2 to $3½ Billion	OVER $3½ Billion
INCOME, per loan						
Svcg. Fees	$147.76	$150.48	$123.18	$139.79	$148.78	$131.73
Net Gain Fcl.	(0.68)	(2.50)	(1.48)	(2.67)	(3.62)	(8.36)
All Oth. Inc.	$ 33.00	29.45	26.83	23.06	30.78	36.82
TOTAL SVC INCOME	$180.08	$177.43	$148.53	$160.18	$175.94	$160.18
EXPENSES, per loan						
Personnel	$ 60.89	$ 39.78	$ 35.48	$ 30.86	$ 28.80	$ 30.56
Occupancy	7.28	4.83	3.96	2.90	4.63	3.07
EDP	13.16	10.88	6.98	5.97	7.39	4.92
Oth. Dir. Op.	33.80	15.79	15.16	17.63	21.03	18.73
Prov. Loan Losses	0.23	0.42	3.22	4.52	3.13	5.60
TOT. NET SVC EXP	$115.38	$ 71.71	$ 64.80	$ 61.85	$ 64.98	$ 62.89
ACPC (Amortization of cost of purchased servicing)	$ 7.51	$ 7.45	$ 8.61	$ 16.26	$ 22.42	$ 21.29
Net Svc. Inc.	$ 57.19	$ 98.27	$ 75.14	$ 82.07	$ 88.53	$ 76.00
Profit Margin	31.8%	55.4%	50.6%	51.2%	50.3%	47.5%
Number of Loans Svcd. per Emp.	400	452	589	614	631	607
Growth in $ Serviced	(1.7)%	14%	11.5%	17%	13%	13%
Servicing Expense Ratio	.2930	.1818	.2099	.1763	.1804	.1836
Avg ln.sz.	$39,381	$39,452	$30,872	$35,086	$36,016	$34,258
Number of firms	24	21	16	23	15	12

TABLE 8

Income Statement, Servicing, by Geographical Region (1984)

	NE	NC	S	W
INCOME; per loan				
Svcg. Fees	$128.93	$118.71	$132.16	$175.38
Net Gain Fcl.	(0.07)	(4.26)	(6.10)	(7.73)
All Oth. Inc.	44.56	27.47	26.84	30.11
TOTAL SVC INC.	$173.42	$141.92	$152.90	$197.76
EXPENSES; per loan				
Personnel	$ 34.93	$ 27.01	$ 28.55	$ 40.22
Occupancy	4.64	2.64	3.42	4.71
EDP	4.88	4.07	7.09	9.09
Oth. Dir. Op.	24.90	16.58	15.62	23.30
Prov. Loan Losses	6.53	5.37	1.56	6.00
TOT. NET SVC EXP	$ 75.88	$ 55.67	$ 56.24	$ 83.32
ACPC	$ 21.69	$ 12.42	$ 20.06	$ 24.68
NET SERVICING INC.	$ 75.85	$ 73.83	$ 76.60	$ 89.76
Profit Margin	43.7%	52.0%	50.1%	45.4%
Loans Serviced per employee	553	642	650	503
Average Salary, Loan Admin.	$15,087	$13,879	$15,116	$16,652
Growth in Dollar Serviced	24.4%	13.5%	14.1%	8.5%
Servicing Acq. Ratio	1.01	1.04	.94	0.53
Servicing Expense Ratio	.2246	.1773	.1700	.1939
Avg ln.sz.	$33,788	$31,403	$33,081	$42,977
Occupancy Expense per employee	$ 2,416	$ 1,633	$ 2,154	$ 2,337
Number of firms	14	24	45	28

*For composition of regions see accompanying geographical regions map

The EDP expense per loan figure can itself be a difficult number to interpret. A low EDP expense per loan could reflect an efficient, automated operation with a high number of loans serviced per employee. Alternatively, it could reflect a firm with little automation and perhaps low productivity. A more useful measure of a firm's degree of automation is its EDP expense per servicing employee. In 1984, this figure was $3,687 or $6.40 per loan. The 1984 figures were higher than their respective 1983 levels, but below the comparable figures for 1982. Firms controlled by BHCs tend to have relatively lower EDP charges. This may be partly due to cost allocation methods but may also reflect the often lighter investor reporting burden of this type of firm, whose parent may be the major investor.

After climbing 64 percent from 1981 to 1983, *Other Direct Operating Expenses* declined 7 percent in 1984 to $18.96 per loan. Significant cost reductions occurred in the postage, telephone and telegraph and other office supplies items. This may be partly due to advances in EDP capability to handle notification letters to borrowers on adjustable rate loans, which had become widely available at this time.

Provisions for *Loan Losses* have become a significant factor on servicers' income statements in the last two surveyed years, rising 73 percent to $4.20 per loan in 1984 after a major increase to $2.43 in 1983. Typically less than two percent of net servicing expenses, this item jumped to 3.7 percent in 1983 and to 6.5 percent in the following year. Unfortunately, further increases in this item are very likely because the average firm experienced a 70 percent increase in inventory of real estate owned in 1984.

The finding that unit costs stabilized in 1984 may not seem in accord with the experience of some surveyed firms. The changing mix of respondents partly accounts for this. Firms that were included in both the 1983 and 1984 surveys reported significant increases in unit costs and a fall in productivity. These firms averaged less than $60 in unit costs in 1983, while posting 637 loans serviced per servicing employee. In 1984, the corresponding figures were $65.62 in unit costs and 596 loans serviced per servicing employee, figures virtually identical to the 1984 average for all surveyed firms.

A large number of the repeat respondents in both the 1983 and 1984 surveys experienced little change in productivity. For many of those whose productivity declined, it was unusually rapid portfolio growth, a change in organizational structure or major shifts in portfolio due to bulk sales of servicing that increased costs. For others, the greater volume of adjustable rate loan servicing had a significant impact on productivity and cost.

Economies of scale

A major issue in servicing is whether or not unit costs continue to decline as firms grow well beyond $1 billion in dollar volume serviced. The existence of such economies of scale could lead to a major change in the character of mortgage banking that would have an important impact on all servicers. To develop a portfolio of say, $5 billion or more, mortgage banking companies would have to embark on an aggressive acquisition strategy that would probably focus on bulk purchases. The result could be a large number of what are now regarded as large servicers ($600 million to $1½ billion), adding to their portfolios by originating their own loans and purchasing loans servicing released and selling blocks of their portfolios to the "mega-servicers."

The 1983 data raised questions about the extent of scale economies in mortgage banking. It appeared that, at some point, unit costs begin to rise as dollar volume serviced increases. Thus, when the more than $1 billion category in the 1983 survey was broken down into smaller groups, it was found that the $1 to $2 billion category had the highest productivity and lowest unit costs of all categories and that unit costs were significantly higher for the more than $3½ billion group.

The 1984 data, however, tell a somewhat different story. All the major dollar volume size categories over $600 million had roughly similar unit costs. The $1 to $2 billion group had the lowest unit costs at $61.85 and recorded 614 loans serviced per servicing employee. Indeed, many regard this to be the optimal size portfolio from the point of view of unit servicing costs. The $2 to $3½ billion category had somewhat higher unit costs at $64.98 despite recording the highest productivity, 631 loans serviced per servicing employee, of any of the main dollar volume categories. Such firms may have found that growing beyond the $2 billion range required the introduction of an additional layer of management as well as additional facilities and equipment. This causes at least a temporary upturn in unit costs until the additions to personnel and facilities become fully utilized. The more than $3½ billion group had somewhat lower unit costs than the preceding group, at $62.89, but slightly lower productivity, servicing 607 loans per servicing employee.

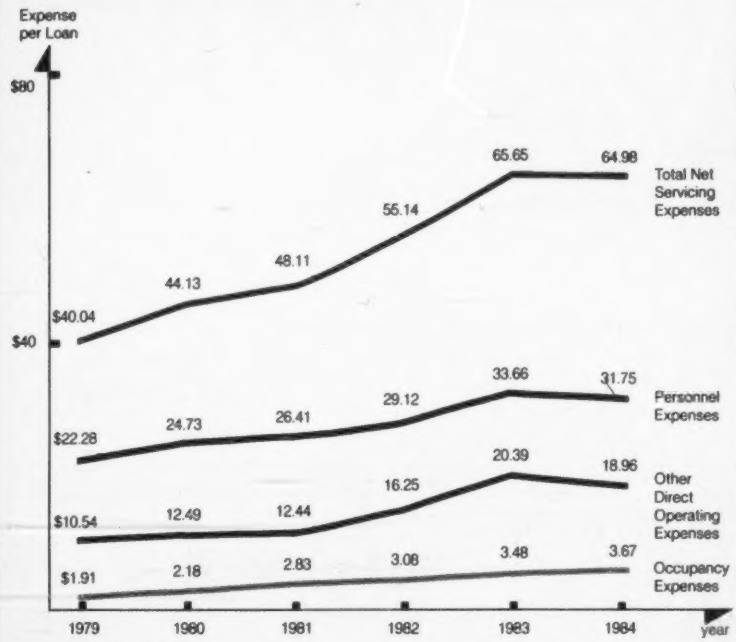
> **"The evolution of an active, well-functioning secondary market in servicing was a key development in the servicing area in 1984."**

The very largest firms—those firms servicing more than $5 billion—were found to have very low unit costs, averaging $57.06 per loan while attaining 614 loans serviced per servicing employee. Most of their cost savings compared with the $1 to $2 billion group occurred in the personnel area. The large servicers' loan administration personnel salary averaged roughly $14,000 per employee, considerably below the industry average of $15,256 and, for example, the $1 to $2 billion categories' figure of $15,018.

The significance of the finding of low unit costs among the largest servicers is tempered, however, by the fact that many smaller firms, some with the less than $1 billion in dollar servicing volume, are also efficient servicers. For example, the $600 million to $1 billion group averaged 589 loans serviced per servicing employee while recording $64.80 unit servicing costs. It is true that the $300 to $600 million category, an efficient size category in the 1983 survey, recorded a disappointing $71.71 unit cost and 452 loans serviced per employee. However, the rather low servicing acquisition ratio of .50 for this category in 1984 could well explain its unimpressive cost figures. Firms in this category experienced an increase in portfolio size of only half their origination volume. They also had an average loan size serviced of $39,452. This often indicates the sale of the servicing rights of seasoned loans while the servicing on new originations was retained. If these firms sold seasoned loans late in the year, their average volume of servicing for the year as a whole exceeded the end-of-year figures on which the unit cost calculations are based. Thus, the unit cost

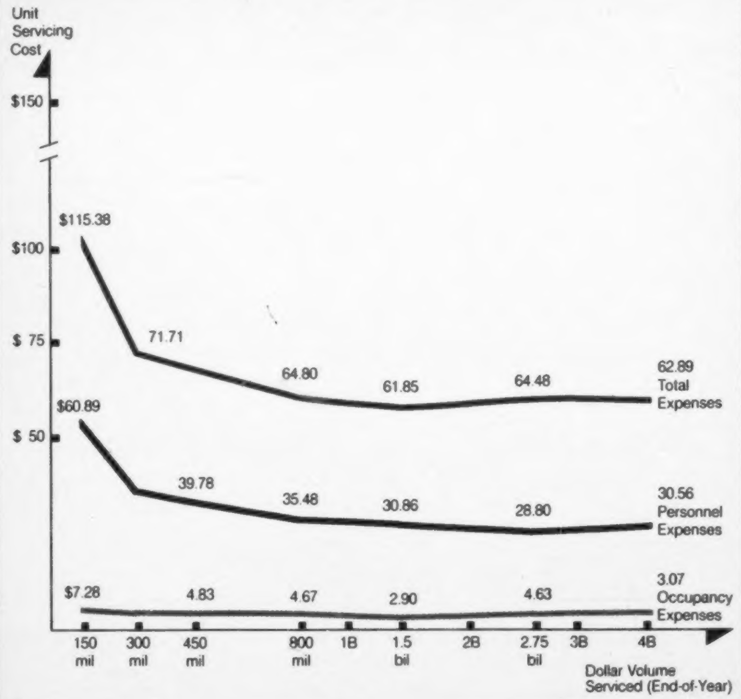
GRAPH 1

Selected Servicing Cost Components, 1979-1984



GRAPH 2

Selected Servicing Cost Components, 1984, by Dollar Volume Serviced



figures for such firms would be overstated.

Thus, there is still reason to believe that firms with more than $300 million serviced can attain relatively good unit cost and productivity figures.

When viewed in terms of number of loans serviced, the size to efficiency relationship becomes clearer. Firms servicing more than 80,000 loans achieved the lowest unit cost, $59.88, of all categories chosen and registered 622 loans serviced per employee. Firms servicing between 40,000 and 80,000 loans achieved nearly as low unit costs, $61.14, with even higher productivity of 651 loans serviced per employee. Significantly lower personnel compensation and other direct operating expenses for firms servicing more than 80,000 loans offset their higher provision for loan losses figure to account for their cost differential relative to the 40,000 to 80,000 loan category firms.

A major surprise was the relatively high unit cost and low productivity levels recorded by firms in the 20,000 to 40,000 loan category. This category registered the lowest unit cost figures in the 1983 survey and has generally been regarded as a highly efficient portfolio size. In 1984, firms in this size category averaged unit costs of $76.40 and 549 loans serviced per employee. However, these figures are largely the consequence of highly dynamic portfolio change by several firms in this category. Many of the firms with high unit cost figures experienced either very high or negative portfolio growth, most being either big buyers or big sellers of servicing. A high rate of portfolio growth can generate high setup costs, the need for additional personnel, etc. Selling large blocks of servicing, on the other hand, can result in large unit cost numbers (especially if the sale was made late in the year), while reducing the end-of-year number of loans serviced. Because the number of loans serviced figure used in generating the unit cost number is the average of beginning and end-of-year number of loans serviced, the denominator of the unit cost measure is disproportionately small. This results in a unit cost number that understates the efficiency of the operation. It also results in a lower productivity figure.

TABLE 9

Type of Ownership

	Bank Holding Co. Controlled	Other Contr'd Subsidiary	Privately Held
All Firms:			
Number of Loans Svcd. per Servicing Emp.	646	533	520
Unit Servicing Cost	$57.35	$77.13	$74.24
Firms With More Than 1 Billion Dollars Svcd.			
Number of Loans Svcd. per Servicing Emp.	662	556	552
Unit Servicing Cost	$56.00	$76.31	$64.16

*Refers to subsidiaries controlled by entities other than Bank Holding Companies or Savings and Loan Associations.

Effects of portfolio growth on costs

Both high and negative rates of portfolio growth tend to have adverse effects on servicing costs. The 64 firms experiencing between 0 and 20 percent growth in dollar volume serviced averaged $58.37 unit costs. Firms with negative growth in dollar volume averaged $75.72, while firms experiencing growth in excess of 20 percent had average unit costs of $76.52.

Firms with negative growth rates face the need to curtail the size of their staffs and perhaps also cut back on overhead expenses. These adjustments take time and so unit costs increase temporarily. Firms with high growth rates, as mentioned earlier, often make large additions to personnel and facilities to prepare for future growth. Their unit costs may also be high during the transition to a larger operation.

The effects of growth in dollar amount of servicing on unit costs depends significantly on the correlation between growth in the number of loans serviced and the dollar volume of servicing. This correlation is not as strong as might be expected. It is not uncommon to find firms with very low rates of growth of number of loans serviced recording relatively high rates of growth of dollar volume serviced. For example, the very heavy buying and selling of servicing that occurred in 1984, as sellers took advantage of unusually high prices paid for portfolios, appears to have widened the disparity between number and dollar volume. Firms selling seasoned servicing in bulk and putting large amounts of newly originated loan servicing on their books could have relatively low rates of growth of number of loans serviced and relatively high rates of growth of dollar volume serviced. It was not uncommon for firms with nearly zero rates of growth of number of loans serviced to experience a growth rate of 20 percent or more in dollar volume serviced.

Type of ownership

Mortgage companies controlled by BHCs enjoyed unusually low unit servicing costs in 1984. Firms in this category averaged $57.35 in servicing cost per loan, far below the unit cost figure of $76.33 for the remaining firms in the study. (See Table 9) These firms also averaged 646 loans serviced per servicing employee compared with the 533 figure for the remaining firms. Privately held mortgage companies averaged $74.24 unit costs and 520 loans serviced per servicing employee, while mortgage banking firms in the Other Controlled Subsidiary category averaged $77.13 and 533 respectively.

> **"GNMA servicing, with relatively high servicing fees and a high degree of transferability, generally commanded the highest prices."**

A large part of the reason for the relatively low cost recorded by BHC subsidiaries is size differentials and scale economies. On average, privately held mortgage banking firms have smaller servicing portfolios than subsidiaries of BHCs. Among the mortgage banking firms servicing more than $1 billion, the BHCs subsidiaries had an average unit cost of $56.00 and 662 loans serviced per servicing employee; for the large privately held firms, the figures were $64.16 and 552 respectively. The comparable figures for the Other Controlled Subsidiaries were $76.31 and 556.

Besides their high servicing employee productivity, BHC mortgage banking subsidiaries have relatively lower average loan administration personnel salaries and enjoy a relatively smaller allocation of expenses for occupancy and electronic data processing from their parents. Their provisions for loan losses are also lower. The degree to which these cost differences are real, rather than a reflection of differences in cost allocation methodology, however, cannot be determined from available data.

Unit costs

There were 20 firms in the 1984 survey with unit costs less than $50. (See Table 10) Of these "low cost servicers," six serviced portfolios of less than $1 billion, while seven serviced portfolios between $1 and $2 billion.

Much of the cost savings experienced by the low cost servicers occurred in the personnel area. The combination of extremely high productivity (733 loans serviced per servicing employee) and relatively low loan administration personnel salaries of $12,543 resulted in personnel costs of only $20.63 per loan. This was significantly below the survey average of $31.75.

Those firms with unit costs of between $50 and $60, on the other hand, recorded average salaries of $14,997 and productivity of 633 loans serviced per servicing employee, figures close to the average for surveyed firms. However, both the lowest cost and the $50 to $60 unit cost servicers were well below average for provisions for loan losses per loan. Indeed, it is this item that explains most of the difference between the $50 to $60 unit cost group from the next higher $60 to $70 group.

Firms in the $70 to $80 unit cost group recorded slightly below average productivity of 543 loans serviced per employee while incurring average loan administration personnel salary expenses of $18,158, well above the industry average. This explains both their relatively high $39.41 personnel expense per loan and, as a result, their somewhat above average unit costs.

The effects of a rapid rate of portfolio growth and large scale sales of bulk servicing on unit cost figures is evident when the higher unit cost categories are viewed. Firms with unit costs in the $80 to $120 range experienced a growth in dollar volume serviced of a mere 2.9 percent, while recording a servicing acquisition ratio of .17. These figures indicate large servicing sales, which accounts for the high unit cost figure.

Firms incurring unit cost figures in excess of $120 experienced unusually high rates of portfolio growth, averaging 37 percent over the course of the year. As noted, exceptionally high rates of portfolio growth can add significantly to unit costs.

Geographical regions

Unit servicing costs tended to be highest in the Northeast and the West in 1984, while falling well below the survey average in both the Northcentral and Southern regions of the country. A combination of relatively high loan administration personnel salaries and somewhat below average productivity resulted in an average unit cost of $75.88 for the Northeast region. A high 24.4 percent rate of growth of dollar serviced and large scale purchases and sales of servicing also had a detrimental effect on their cost figures. On the whole, they were net acquirers of servicing in 1984, recording a servicing acquisition ratio of 1.01.

Geographic Regions

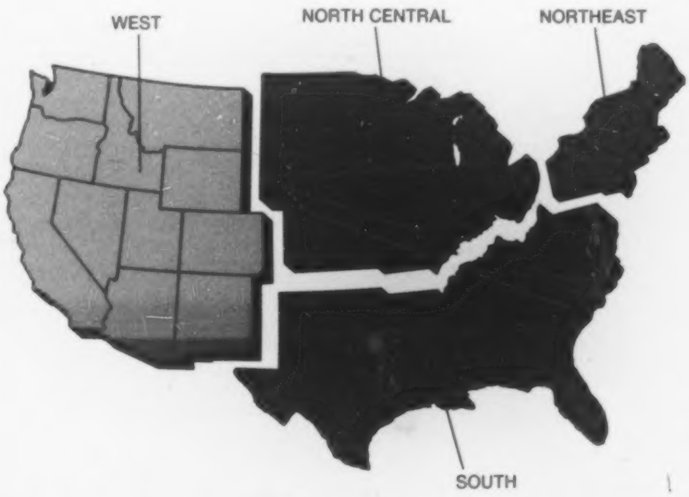


TABLE 10

Servicing Expenses, Per Loan: Grouped by Unit Cost

	Less than $50	$50 to $60	$60 to $70	$70 to $80	$80 to $120	Over $120
Expenses; per loan						
Personnel	$20.63	$31.30	$28.47	$39.41	$46.23	$65.15
Occupancy	2.27	2.81	3.60	5.21	5.27	9.20
EDP	4.83	4.54	6.94	7.09	10.34	10.67
Other Direct	14.29	16.71	17.01	21.13	27.46	39.22
Prov. Loan Losses	0.29	0.52	7.56	1.93	6.99	29.85
TOTAL NET SVC. EXP.	$42.32	$55.88	$63.58	$74.77	$96.29	$154.09
Loans serviced per employee	773	596	633	543	454	352
Average Salary, Loan Admin.	$12,543	$14,997	$14,465	$18,158	$17,482	$17,182
Growth in Svcd.	12.8%	15.8%	12.1%	14.4%	2.9%	37.0%
Servicing Acq.Ratio	.98	1.07	.65	.73	.17	1.31
Average Loan Size	$29,838	$35,219	$35,442	$35,795	$40,123	$50,656
Profit Margin	61.5%	56.5%	49.5%	45.7%	29.3%	22.9%

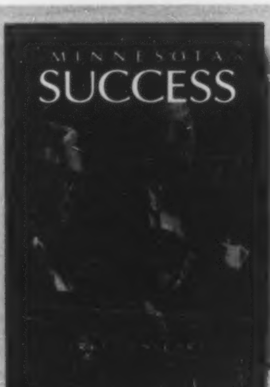
Servicing costs were also high in the West, averaging $83.32 for the 28 firms of that region in the survey. High loan administration personnel salaries, averaging $16,652, contributed to the higher costs. However, large scale shifts in the servicing portfolios of these firms were a more important factor raising their cost figures. The firms in the West recorded a growth in dollar serviced of only 8½ percent while posting a servicing acquisition ratio of .53. Many firms in this region took advantage of the prevailing unusually high prices for servicing, selling much of it toward the end of the year. This means they were servicing a good deal more loans than would be reflected in their beginning and end-of-year volume numbers and incurring the associated costs. Thus, they were much more efficient servicers than the figures would indicate. The average outstanding principal balance of $42,977 serviced by firms in the West was $9,000 more than in any of the other geographical regions.

The question of the relative efficiency of the Western firms can be clarified by confining our attention to those firms in the West that were included in both the 1983 and 1984 surveys. In 1984, the repeat respondents in the West recorded unit servicing costs of $83.61; 496 loans serviced per employee; a 7.1 percent growth in dollar volume serviced; and a servicing acquisition ratio of .51. In 1983, these same firms registered unit costs of $64.25; 586 loans serviced per employee; a 14.4 percent growth in dollar volume serviced; and a servicing acquisition ratio of .82. The major drop in the servicing acquisition ratio in 1984 indicates large scale sale of servicing, which, in turn, accounts for the deterioration in the unit cost and productivity levels.

The lowest unit cost region, on average, was the Northcentral, followed closely by the South. Firms in the Northcentral part of the country had average unit costs of $55.67, while registering 642 loans serviced per servicing employee. Their high productivity, combined with a low $13,879 average loan administration personnel salary, accounted for much of their cost savings. Also contributing to their low unit cost was their moderate 13½ percent rate of growth of dollar serviced. Firms in this region had a servicing acquisition ratio of 1.04. They also had large servicing operations relative to their origination volume. Their ratio of dollar volume originated to dollar volume serviced was .115, the lowest of the four geographic regions.

The South averaged $56.24 in unit servicing costs, while recording 650 loans serviced per employee. The slightly higher productivity relative to the Northcentral region was more than offset by higher average loan administration personnel salaries of $15,116. However, the considerably lower provision for loan loss of $1.56 per loan, compared with the Northcentral region's average of $5.37, put their net servicing expense per loan very near that of the Northcentral region.

With the exception of the delinquency and foreclosure problems, the basic fundamentals of servicing cost structure appear to have improved in 1984. A key to future profitability will be the ability to avoid cost increases associated with problem loans. ☐



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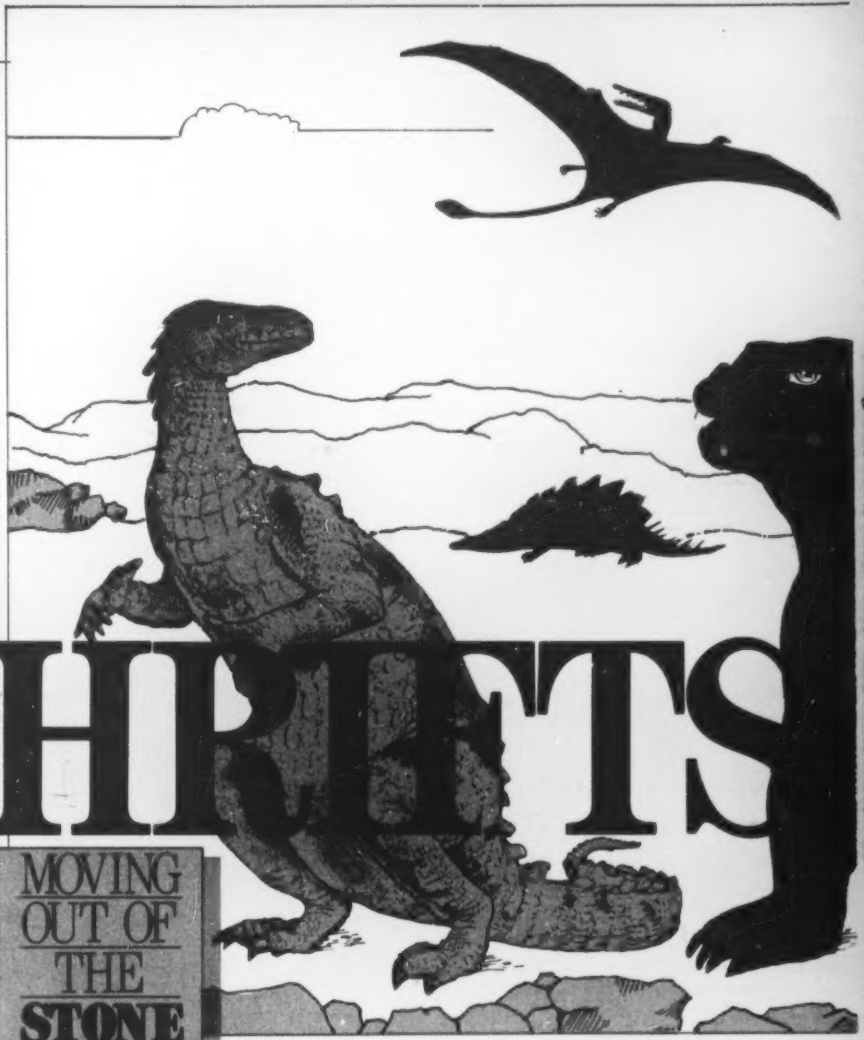
THRIFTS

MOVING OUT OF THE STONE AGE



Savings institutions have been in an evolving mortgage market for the past 15 years. Regulatory, legislative, technological and market forces have acted in concert to change the nature of the mortgage business. During this period, more and more institutions have dramatically changed their strategy, moving from portfolio lending to mortgage banking. In retrospect, it is easy to see why institutions did so and why more will act similarly in the future.

High interest rates and deregulation forced many institutions away from portfolio lending and into mortgage banking operations in the early 1980s. Ironically, it will be low interest rates and new regulation, in the form of accounting rules, that will encourage even more to do so this year. In addition to these forces, new technology and competitors will create an environment that will be most unforgiving to those not willing to change or adapt to a new financial world. Simply getting into mortgage banking may not be enough and well-defined strategies will have to be devised and implemented.

Out of the stone age

Portfolio lending was profitable and almost risk-free in the past. Money came in at a regulated level (consumers had no savings alternative) and was lent out at a comfortable profit. Lenders and borrowers benefited from this system, but savers did not.

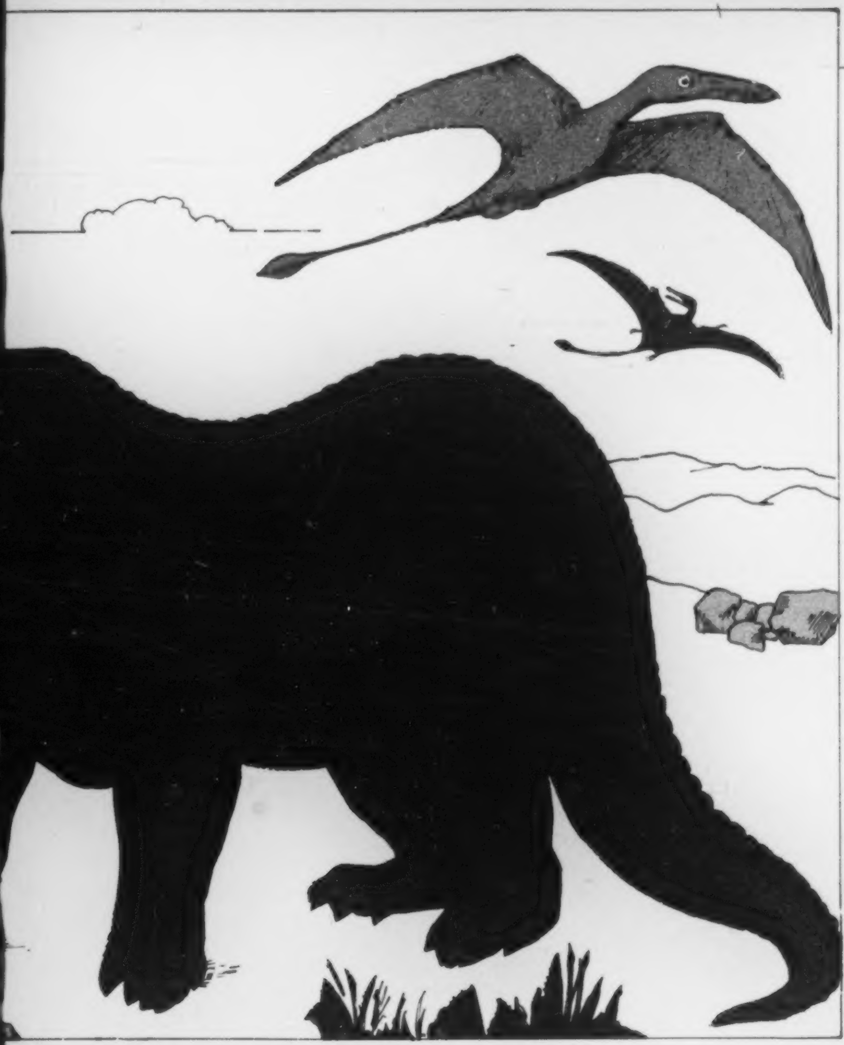
As the savings revolution in the 1970s spawned money market funds with the resulting disintermediation for depository institutions, the blanket of protecting regulations was lifted to expose a shivering industry to the icy winds of a new age. Congress turned a deaf ear on pleas from the savings industry to impose capital requirements on these new funds. The political reaction came, in large part, to the overnight political muscle of the savings alternatives as little old ladies, construction workers and other small savers became sophisticated rate shoppers. This new constituency expressed overwhelming approval for market rates of returns on their deposits. A corollary to the American dream of homeownership became unrestricted access to high yields on savings.

Savings institutions, therefore, found themselves competing with slick new competitors. It was no longer bank versus thrift, but depository institution versus the computer-driven mutual fund. Regulations no longer set rates but capital markets did. To make matters more complicated, the Federal Reserve Board decided in October 1979 that monetary supply and not stability of interest rates, would be its prime concern. While this policy change has been credited for breaking the back of inflation, it killed several thrifts in the process. However, policy makers were willing to accept that price and are still content to back this policy.

The regulatory and legislative policy environment for thrifts, therefore, suggests that no one is willing to guarantee a stable environment. The consumer wants the highest rates of return on savings and the best possible terms on mortgages. No politician is willing to stand between consumers and their desires on behalf of the lender.

First migration to mortgage banking

The deregulation of interest rates and the Fed's policy change resulted in sharply rising costs of funds for savings institutions with fixed-rates of returns on assets. The resulting earning squeeze in 1979 and 1980 forced many thrifts to change their approach to the mortgage business. Instead of gearing profitability to the positive



spread on the portfolio, institutions sought to increase reliance on fee income in the form of mortgage banking.

This phenomenon is best illustrated by data that shows the remarkable increase in the ownership of mortgage banking companies by savings and loans. Chart 1 shows the ownership of the top 100 mortgage banking companies in 1975 and 1985. Every major category decreased with the notable exception of savings institutions.

An example of a major thrift mortgage banking operation is City Federal Savings Bank in Bedminster, New Jersey which is the top Fannie Mae seller/servicer. But Goldome FSB, Buffalo, New York; Commonwealth Savings, Houston, Texas; Anchor Savings Bank, Hewlett, New York; and Gill Savings, Houston, Texas also operate some of the nation's largest mortgage companies and are representative of the major segment of thrifts with well-established commitments to mortgage banking.

ARMs no portfolio panacea

Those thrifts that remained committed to portfolio lending after the tough period of the early 1980s placed much stock in adjustable rate mortgages (ARMs). The feeling was and is that a portfolio of loans that adjust with current interest rates will be protected from interest rate risk.

The first problem the industry had to overcome was restrictive regulations and laws. This was addressed fairly easily. The major obstacle was, however, the reluctance of the consumer to accept the interest rate risk associated with these loans.

After several years of experimentation, the mortgage industry learned that in order to make ARMs palatable, the consumer had to get a sufficiently cheaper rate comparable with a fixed-rate mortgage, in the area of 1.5 to 2 percent and there must be limits on the amount that a loan could rise on an annual and life-of-loan basis. The most popular loan is one with a 2 percent annual cap and a 5 percent life-of-loan cap.

These concessions detracted from the lender's perspective, but many in the industry approached this business with a vengeance. As fixed-rate loans hovered around the 14 percent level, ARMs became the favored instrument of those consumers getting loans, with more than 60 percent of originations being ARMs.

While ARMs were originated in large numbers during times of high interest rates, their performance as portfolio instruments has not been sufficiently tested to draw any finite conclusions, but some trends are emerging. Had rates continued to rise, the obvious concern of many dealt with payment shock. However, because rates have fallen substantially during the past six months, we will not be able to assess the resilience of ARM borrowers.

The major question now facing portfolio lenders with substantial ARM portfolios is at what point will ARMs refinance and will lenders have profited in spite of the concessions necessary to make the loan. Studying ARM refinancing is difficult because there will be no comprehensive data for several months. Conventional wisdom would suggest that adjustable rate loans should not refinance as quickly as fixed-rate loans because borrowers can enjoy lower rates without having to refinance. On the other hand, some believe the borrowers' fixation for a fixed-rate loan is so strong that they will refinance at a similar or higher coupon rate to lock in the assurance of fixed-rate lending.

While current analysis must rely on anecdotal evidence, the emerging trend is startling. Conversations with some at the heart of the market suggest that ARMs are prepaying at an astounding rate and that borrowers are willing to pay points and higher monthly payments to get the security of a fixed-rate mortgage.

Tom LaMalfa, vice president, secondary market services at MGIC, finds that "borrowers are refinancing ARMs at a much higher rate than bor-

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rowers with fixed-rate loans. Even ARMs currently in the mid-9 percent range are refinancing into fixed-rate loans that are 50 to 75 basis points higher." Dale P. Riordan, executive vice president at Fannie Mae concurs. "We are seeing borrowers with ARMs taking higher fixed-rate loans, plus the points associated with originating the new loan." LaMalfa predicts that of the $250 billion in ARMs originated since the fourth quarter of 1982, only $125 to $150 million will remain on thrifts' books by the end of the third quarter of this year.

If these observations prove to be indicative of the refinancing of ARMs, then the concept of the ARM as an ideal asset for thrifts has been shaken. ARMs that must be generated with a loss leader or discounted rate may encounter either credit quality problems with rising rates, or will be converted to fixed-rate loans with falling rates.

Computers abetting trend to mortgage banking

A dissertation on the mortgage market cannot be complete without a recognition of the effects of technology. Computers have helped lay a foundation for a truly national mortgage market, with rates and terms quoted instantaneously. Computers have made it harder for a portfolio lender to benefit from an inefficient market that enabled high yielding loans to be booked. Thanks to computers, no community is too small not to be plugged into the national market.

Computers have also brought down

CHART 1

Owners of 100 Largest Mortgage Companies

Company Affiliation	1975	1985
Banks	37	32
Privately Owned	46	26
Savings and Loans	4	26
Financial Service Co.	7	10
Industrial Firm	3	3
Homebuilder	3	3

Source: Presented by Terry W. Malone at the MBA National Mortgage Servicing Clinic, February 1986

Peter E. Knight is vice president and director of mortgage finance at the National Council of Savings Institutions in Washington, D.C. He is the author of several articles on mortgage finance and serves as editor of International Capital Markets Report.

interest rates on mortgages and decreased the attractiveness of the portfolio instrument by creating new ways of tapping capital markets more efficiently. Collateralized mortgage obligations (CMOs), a computer-driven financial product developed by so-called rocket scientists on Wall Street, make it possible to raise money for fixed-rate loans more cheaply.

On the positive side, computers have enhanced the attractiveness of mortgage banking by increasing the profitability of servicing. Without computers, servicing could not be the profit center now established by so many thrifts. The liquidity of servicing has also been computer-assisted which enhances it as an asset.

Computers have also enabled new players to enter the market. While some computer-based mortgage origination systems have been slow to get off the ground as planned, such as RNMA (the Realtors National Mortgage Association) and Loan Express, computers are helping facilitate nationwide operations that may well grow to be major market players in the next few years.

The epoch of the mid-1980s

That leaves us in the mid-1986 stage of the continuing evolution of the mortgage market. The poor portfolio lender has been battered by the rising rates and deregulation of the late 1970s and early 1980s. Surprisingly, he has been further tested by falling rates as ARMs and high coupon fixed-rate loans convert to lower rate fixed loans.

This falling rate market will encourage more thrifts to enter mortgage banking in an effort to eliminate the risk embodied by portfolio lending. Now is a good time to do so because the volume of business being written this year will shorten the time frame necessary to reach a critical mass of profitability.

Another major incentive for portfolio lenders to sell loans comes from the bastion of the accounting industry, the Financial Accounting Standards Board (FASB). New FASB rules becoming effective this year will further penalize portfolio lending by having all loan fees amortized during the contractual life of the loan while sold loans may have all their fees booked as income. Because mortgage loan fees represent a substantial part of the industry's profits, many institutions will consider selling loans for the first time so that they can immediately book fees as income.

> "Simply getting into mortgage banking may not be enough and well-defined strategies will have to be devised and implemented."

Accounting treatment for servicing spreads also provides an important incentive for some institutions to enter mortgage banking. Current practice is for the seller to take into income the present value of the interest differential which exceeds the normal servicing fee for the contractual life of the loan. This follows the savings and loan audit guide.

Some lenders are selling current loans at a loss to create inflated servicing spreads. For instance, if the required yield of Fannie Mae is 11.0 percent, most loans are originated at 11.375 percent to include the servicing fee. In this case, a lender would sell the loan to Fannie Mae with a coupon of 10 percent and retain a partial participation of 100 basis points. While the institution takes a loss on the sale of the loan, it may book as income the present value of the interest in excess of the servicing fee, which will more than compensate for the loss on the sale.

CHART 2

	1983	1984	1985
Mortgage Debt Outstanding	$1.81 trillion	$2.02 trillion	$2.25 trillion
Change from Previous Year	—	**11.6%**	**11.4%**
Portfolio of 20 Largest Mortgage Servicers	$133.2 billion	$152.8 billion	$209.4 billion
Change from Previous Year	—	**14.7%**	**37%**

Source: SMR Research Corporation

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The big get bigger

If all this has not been difficult enough for portfolio lenders, new players are emerging on the market that are highly capitalized and backed by some of the nation's largest manufacturing, insurance and retail corporations. They are aggressively operated and hope to take a major part of the business from all existing mortgage participants, mortgage bankers as well as portfolio lenders.

A recent study, "The Consolidation of the US Mortgage Industry," published by the SMR Research Corporation in Budd Lake, New Jersey, examines the trend to a national market with fewer, bigger players.

Stuart Feldstein, president of SMR, commented, "The largest players in the market are growing two to three times as fast as the overall market which is symptomatic of an industry going through dramatic consolidation." Chart 2 reflects this trend as the growth in servicing by the largest players has outpaced the growth in the volume of outstanding loans.

This development will accelerate according to the SMR study and put added pressure on thrift management to study its market and role therein. The question arises then of not only what to do with the mortgage once originated, but also how to obtain that business in the first place. In a year of record originations in the $300 billion plus level, there is more than enough business to go around. The study asks though, what happens to the future market when origination volume recedes to more normal levels.

How are thrifts meeting these new challenges? Feldstein observes, "You see some savings institutions doing interesting and exciting things in the mortgage field and others burying their heads in the sand as the world changes around them."

Thrifts that are ignoring change are outweighed by those who are changing their business tactics to meet the new challenges of a further evolving market. Any business plan in the future must be based on careful analysis, planning and be backed up by forceful implementation. The market of tomorrow will be much less forgiving than that of the past. □

MORTGAGE MARKET TRENDS

Just when we thought the party might be ending as the rise in interest rates this spring began easing mortgage loan demand, interest rates once again reversed direction, with the three-month Treasury bill rate falling by about 65 basis points during the last month to the lowest level in almost nine years. To be sure, the behavior of interest rates during this economic recovery has been dramatically different from what was experienced during the cyclical expansion of the latter half of the 1970s. For example, between the tenth and eighteenth quarters of the last recovery, interest rates on bellwether 10-year Treasury securities increased by more than 170 basis points. In sharp contrast, during the comparable period of the current recovery, rates on 10-year Treasuries fell by 560 basis points. As a result, residential lending and construction activity has been exceptionally strong and recent developments confirm the view that the interest rate environment will remain conducive for a continuation of healthy housing activity for some time.

Until recently, most forecasters, including the Mortgage Bankers Association believed that the sharp drop in interest rates and oil prices, the stock market rally and the decline in the foreign exchange value of the dollar during the last year, would together generate an acceleration in economic growth during the second half of this year. In turn, this pickup in growth was expected to put modest upward pressure on interest rates as the year progressed. It is now apparent that this widely anticipated improvement in second half growth from the lethargic first half pace has been postponed or may not materialize at all this year.

In the first place, business investment expenditures are likely to remain flat in the face of stubbornly high excess capacity. So far in 1986, manufacturing capacity utilization has averaged 79.5 percent, compared to 85 percent during the comparable period of the recovery in the late 1970s. Moreover, the negative effects of declining oil prices on total investment activity have been underestimated, and the upcoming passage of tax reform legislation will aggravate an already weak investment spending outlook due to the loss of the investment tax credit and cutbacks on depreciation allowances. Further, the anticipated pace of consumer spending will provide only limited opportunities for a rebound in inventory investment spending. Thus, industrial production is not likely to get much of a lift from an improvement in business investment.

At the same time, despite the sharp drop in the foreign exchange value of the dollar over the last year, the U.S. merchandise trade deficit remains frustratingly large. While U.S. export growth has been improving slowly, import competition remains fierce as foreign producers have slashed profit margins rather than raise their prices. Although import penetration will eventually slow down as foreign manufacturers are forced to raise their prices, it is now clear that improvement in the trade balance will be slow going. As a result, the trade deficit will impart a greater than anticipated drag on industrial production this year. This in turn, will severely limit the improvement in manufacturing sector employment that supposedly would provide renewed vigor to wage and salary growth this year.

In addition, although the sequestration provision of the Gramm-Rudman-Hollings (GRH) legislation has been declared unconstitutional, fiscal policy is, nevertheless, predicted to be less stimulative than it has been in recent years. The conventional wisdom is that while the GRH budget deficit targets will not be met, the budget deficit will gradually be lowered through a combination of modest spending cuts and tax increases.

Thus, the combination of an emerging picture of continued slow growth and upcoming legislative developments that could further limit improvements in the immediate pace of economic activity, fostered a change in market sentiment that halted and reversed the recent uptick in interest rates. Rather than anticipating a gradual firming in monetary policy in response to a faster-growing economy, financial markets correctly anticipated further stimulative moves by the Fed to shore up a sagging economy. The recent drop in the Fed discount rate to 6 percent from 6.5 percent confirmed these expectations.

These developments strongly suggest that housing activity will remain on the high road at least through the summer and possibly into the new year. Interest rates on 30-year, fixed-rate mortgages are headed back into the single digits and could stay there through the year. Just how low they go will depend on the strength of loan demand unleashed by the downward drift in rates. No doubt, refinancing activity, which began to level off in the late spring will remain strong. Although it seems improbable that a repeat performance of the torrid flood of refinancing applications experienced in April and May will occur, this component of loan demand will remain substantial this year as long as rates stay below 10 percent. Housing sales-related originations will also stay brisk, although housing sales may begin to slow later in the year if employment and real income growth fail to respond to the monetary stimulus presently in the pipeline. Clearly, at this juncture, deterioration in job creation and income growth pose a greater immediate threat to the housing recovery than does an upturn in interest rates.

Overall, residential loan origination volume could well exceed $400 billion for the year, with refinancing accounting for 35 to 40 percent of that total. Mortgage bankers will most likely experience a pronounced increase in market share as they traditionally benefit from periods of strong demand for Federal Housing Administration/Veterans Administration loans and fixed-rate mortgages in general. As such, the principal challenges facing mortgage bankers through the remainder of the year will continue to be in the timely processing of loan applications and in adequately hedging pipeline risk in what has been a most volatile year.

Edison R. Zayas
Senior Economist
July 15, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rate			Actual			Seasonally Adjusted Annual Rate		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985												
DEC	115	71	44	1,882	1,181	701	128	68	60	1,839	1,077	762
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,861	1,187	674
FEB	107	71	36	2,001	1,317	684	684	68	41	1,808	1,155	653
MAR	151	104	47	1,960	1,305	655	152	99	53	1,834	1,150	684
APR	190	128	62	2,039	1,345	694	180	125	55	1,885	1,256	629
MAY$_p$	190	136	54	1,888	1,346	542	170	121	49	1,785	1,216	569
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
5 MONTHS												
1986	753	518	235				732	486	246			
1985	691	472	219				687	440	247			
1984	730	510	220				727	474	253			
1983	633	451	182				602	402	200			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rate				Actual				Seasonally Adjusted Annual Rate			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1985																
NOV	20	17	57	30	235	210	767	442	21	16	52	32	268	206	725	469
DEC	17	13	57	34	283	261	870	468	19	17	62	30	263	271	844	461
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	290	314	767	490
FEB	13	11	51	33	404	370	745	482	12	12	53	32	287	306	743	472
MAR	21	21	69	40	332	344	763	521	21	20	64	46	276	287	718	553
APR	30	33	79	51	335	370	799	535	29	33	69	49	302	333	727	523
MAY$_p$	26	28	80	55	252	247	839	550	28	31	62	50	273	298	682	532
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
5 MONTHS																
1986	103	103	338	209					105	107	309	212				
1985	83	83	333	193					98	82	314	194				
1984	63	83	391	194					73	80	371	203				
1983	57	70	367	140					54	63	344	142				

HOUSING ACTIVITY (Cont'd.)

YEAR AND MONTH	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1985														
DEC	219	47	350	5.7	$219.4	$88.6	$30.1	$100.7	1,089	618	471	162	113	49
1986														
JAN	213	55	351	6.0	224.0	92.9	29.9	101.2	1,094	628	466	122	81	41
FEB	218	59	342	5.9	225.1	94.8	29.8	100.5	1,110	638	472	118	76	42
MAR	277	88	332	4.5	221.1	95.7	30.8	94.6	1,099	627	472	133	92	41
APR	336	82	336	4.8	224.4	97.6	31.7	95.1	1,133	639	494	129	95	34
MAY$_p$	329	72	334	5.4	224.5	99.8	32.1	92.6	1,134	651	483	147	94	53
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
5 MONTHS														
1986	1,373	356										649	438	211
1985	1,225	295										624	423	201
1984	1,200	293										610	416	194
1983	1,050	270										406	285	121

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type

(Dollars in millions)

YEAR AND MONTH	TOTAL					1-4 UNITS				
	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUL	$31,407	$6,503	$11,709	$11,051	$2,144	$21,273	$5,969	$9,093	$6,110	$101
AUG	34,928	7,792	13,324	11,832	1,980	25,518	7,028	10,996	7,390	104
SEP	35,188	7,422	13,316	12,346	2,104	24,104	6,963	10,483	6,541	117
OCT	36,525	6,548	14,014	13,288	2,675	24,450	6,104	11,032	7,208	106
NOV	32,864	5,660	12,363	11,886	2,955	21,142	5,200	9,357	6,491	94
DEC$_p$	43,586	5,730	15,919	16,189	5,748	22,814	5,158	10,101	7,162	393
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983 TOTAL	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
12 MONTHS										
1985	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
1983	274,751	63,430	103,882	91,500	15,939	197,617	59,762	81,524	55,605	726
1982	132,168	30,729	43,433	49,637	8,369	92,512	27,995	34,783	29,190	544

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUL	$1,804	$53	$974	$604	$173	$8,330	$481	$1,642	$4,337	$1,870
AUG	2,201	239	1,085	665	212	7,209	525	1,243	3,777	1,664
SEP	2,202	287	1,099	656	160	8,882	172	1,734	5,149	1,827
OCT	2,694	150	1,456	700	388	9,381	294	1,526	5,380	2,181
NOV	2,545	183	1,401	716	245	9,137	277	1,605	4,639	2,616
DEC$_p$	5,048	274	2,935	1,111	728	15,724	298	2,883	7,916	4,627
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983 TOTAL	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
12 MONTHS										
1985	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
1983	16,169	566	8,521	5,485	1,597	60,965	3,102	13,837	30,410	13,616
1982	6,790	960	3,171	2,221	438	32,866	1,774	5,479	18,226	7,387

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
JUN	$28,091	$5,731	$14,174	$5,385	$2,801	$105,354	$13,116	$56,079	$19,126	$17,033
JUL	27,791	5,686	14,594	4,928	2,583	99,706	14,684	49,838	17,882	17,302
AUG	32,123	6,588	16,969	5,434	3,132	103,290	14,190	50,198	20,243	18,659
SEP	30,531	6,123	16,055	6,094	2,504	114,357	15,205	50,579	29,268	18,980
OCT	29,039	4,208	16,134	5,775	2,922	110,307	12,436	49,882	29,100	18,889
NOV	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
DEC$_p$	28,511	6,489	14,889	4,693	2,440	109,632	14,091	47,704	31,450	16,378
1984 TOTAL	249,401	70,128	146,184	47,065	20,844					
1983 TOTAL	258,986	44,893	123,361	38,195	17,717					
12 MONTHS										
1985	323,085	59,986	170,763	60,635	31,701					
1984	258,986	44,893	146,184	47,065	20,844					
1983	249,401	70,128	123,361	38,195	17,717					
1982	115,328	42,594	45,184	19,511	8,039					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA[3]	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1985												
NOV	173	78	27	68	128	$8,488	47	$2,795	25	$1,693	56	$4,000
DEC	163	80	22	61	93	6,319	23	1,359	19	1,347	51	3,613
1986												
JAN	205	130	24	51	110	7,298	45	2,659	19	1,304	46	3,335
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	305	211	33	61	115	7,752	57	3,477	23	1,621	35	2,654
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY$_p$	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
5 MONTHS												
1986	1,405	967	114	324	568	38,835	267	16,456	102	7,208	199	15,171
1985	824	316	84	424	467	30,116	113	6,400	65	4,228	289	19,488
1984	823	214	95	514	571	36,270	103	5,459	99	6,389	369	24,422
1983	495	67	148	280	400	23,260	125	5,959	96	5,935	179	11,366

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities						Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued	Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Applications	Issued
1985										
DEC	$1,858	$1,663	$54,987	$3,365	$3,076	$3,425	$6,095	$6,335	$5,699	$4,520
1986										
JAN	1,315	1,188	58,391	3,964	4,880	5,273	3,709	3,300	10,103	5,298
FEB	2,578	1,159	60,752	2,978	5,526	6,044	4,605	4,268	5,973	5,006
MAR	1,917	1,410	62,310	2,260	7,213	7,128	5,318	5,900	14,853	5,059
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAYp	3,538	1,078	67,312	4,491	na	na	na	na	4,863	5,572
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
5 MONTHS										
1986	13,122	7,366	—	16,528	25,842	28,346	19,827	19,061	49,127	28,135
1985	8,825	8,975	—	6,680	14,644	15,480	10,877	9,498	20,814	14,279
1984	8,123	7,958	—	4,836	6,025	6,430	5,081	3,907	15,862	12,995
1983	6,531	7,655	—	6,291	6,410	7,445	7,824	7,391	31,505	20,535

* Year-to-date totals are for three months only

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA NEW[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	
1986								
JAN	10.78%	10.82%	10.93%	10.89%	10.81%	10.00%	10.375%	12.00%
FEB	10.59	10.49	10.50	10.68	10.83	9.89	10.269	11.63
MAR	9.77	10.06	10.10	10.50	10.62	9.04	9.494	11.09
APR	9.80	9.99	9.99	10.27	10.37	8.49	9.300	10.84
MAY	10.07	10.32	10.33	10.22	10.15	8.70	9.663	10.81
JUN	na	na	na	10.14	10.21	8.60	10.050	11.62

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
JAN	9.99%	10.18%	10.22%	10.74%	9.19%	7.16%	7.71%
FEB	9.75	9.90	9.95	10.21	8.70	7.11	7.63
MAR	9.05	9.23	9.27	9.41	7.78	6.57	7.20
APR	9.01	9.08	9.12	9.26	7.30	6.08	6.60
MAY	9.33	na	na	9.50	7.71	6.19	6.62
JUN	9.59	9.51	9.54	9.65	7.80	6.27	6.71

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1985				
JAN	4	80	99	103
FEB	38	105	120	125
MAR	36	127	145	149
APR	54	171	178	182
MAY	57	162	na	na
JUN	na	179	171	174

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,680	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,480	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	280	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH		1-4 Units				5+ Units			
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	[illegible]

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,290	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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MORTGAGE BANKING

SEPTEMBER 1986

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MORTGAGE
BANKING

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ARTICLES

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America's senior population need not be labeled frail, inactive and impoverished. They are living longer, remaining more active and by and large are more financially stable. Rental retirement housing can provide security and independence for this market.

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WHOSE DEAL IS IT ANYWAY?
R. Lynn Tucker
The loan originator and the administration department need to work together to create a very effective and productive environment where the goals and desires of the borrower and lender are met and achieved.

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TAX REFORM: A NEW BUG FOR INVESTORS
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Under the proposed tax changes, the highly leveraged income property investment, where the size and timing of returns have been structured to shelter income from other sources, will probably not fare so well. The value of the returns to the current owner would be substantially reduced. These issues are examined.

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BUSINESS BASICS—CHECKLIST FOR NEGOTIATING A LOAN COMMITMENT
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This article provides a number of major factors that should be considered when establishing the negotiation process.

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AVOIDING THE REFINANCING SQUEEZE
James J. Sheehan
Because of the market's low interest rates, many borrowers are attempting to find ways to prepay old mortgages despite penalties. Some interesting legal issues arise if the borrower intentionally defaults so the lender is forced to call the loan and it can be refinanced. This article explores these issues.

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REAL TIME TRADING SYSTEMS: IS THE MARKET CALLING?
William P. McCauley
Real time trading systems would provide the mortgage industry with direct access to the capital markets for the delivery and accumulation of nonconforming product. This author believes it is not a question of "how" but "when."

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SALES TRAINING: MOVING OUT OF THE REVOLVING DOOR
James L. Hennessy, Jr. and James C. Pratt
American business will spend untold amounts of money to train its salespeople this year. But the mortgage banking business is a notable exception. Will mortgage bankers continue to sacrifice professionalism for production?

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GINNIE MAE SERVICING: ONGOING EARNINGS
Alan E. Grimshaw and Robert D. Johnston
A historical analysis of variation in the rate of return earned on Ginnie Mae servicing is presented in this article.

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THE LAST WORD (BANKRUPTCY WAR UPDATE)
Michael S. Polk
There is an unfortunate trend that has developed in Southern California, which involves a flood of bankruptcy filings and attendant abuses. The current bankruptcy code requires lenders to demonstrate why the debtor should not be protected in bankruptcy instead of why the debtor should be protected.

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Leonard Bogorad

Rental retirement housing is a relatively new concept—but one that has caught on quickly and is a happy solution that meets the needs of many of today's senior citizens. This type of housing enables residents to remain independent, with their own self-contained apartments equipped with kitchens. Rental retirement housing also includes many advantages of a resort hotel—restaurant service (with one or more meals a day usually included in the monthly charge), extensive recreational facilities and activities and housekeeping and linen service. Emergency call buttons and excellent security are provided and van service makes it easy to stay active in the larger community.

As would be expected when so many services are included with fully equipped apartments, rental retirement housing is not inexpensive. Monthly rents generally range from $700 to $2,500. However, the traditional perception that most elderly people are poor is simply not true today. Neither is the idea that most are on fixed incomes; if anything, their incomes are more protected against inflation than those who are younger. Seniors hold a massive amount of

RENTAL Retirement Housing

Running With Renewed Vigor

ILLUSTRATION BY BRIAN LESTER

home equity that can be freed up by those choosing to move to rental housing.

Furthermore, elderly incomes will be climbing and the acceptance of rental retirement communities should increase significantly as they become a better understood housing alternative. Nevertheless, the majority of seniors will continue to live in their own homes, so the market, though strong, is finite.

Developments with independent units and the full range of congregate services—lifecare and rental—currently number about 800 to 900. Only about 300 of these are rental retirement communities. Developers are moving aggressively into this field; developments currently being planned across the country could at least double the rental inventory. Such dramatic short-term growth will certainly spur much broader understanding of the concept. At the same time, even though demand will be increasing rapidly during coming years, some market areas will undoubtedly become oversaturated.

Developers with no experience in marketing and providing service-oriented environments for senior citizens may encounter difficulties. It cannot be emphasized too strongly that effective, sensitive delivery of services is every bit as important as creating and managing attractive, livable apartments. Rental retirement developments that are well-planned and marketed in relation to local market conditions and include quality services, can generate higher returns than rental housing that does not include this range of services.

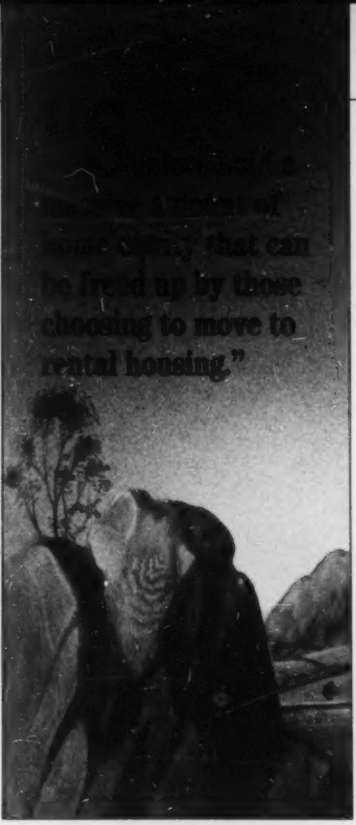
Demographic trends affecting demand

The graying of America is now a familiar concept, but it is only in recent years that people have zeroed in on the actual size of the seniors market for particular real estate or other products. For rental retirement housing, the primary market today is households who are 75 or over (disproportionately widowed women), but younger seniors (age 70 to 74 and to a much lesser extent 65 to 69) and couples may become more attracted to this type of living as its characteristics are more widely understood. In the interim, as shown in Figure 1, it is the older households that will be increasing in number fastest and that is where rental retirement housing is targeted.

Figures 1 and 2 illustrate the absolute increases anticipated for the U.S. elderly population and number of elderly households during the next 15 to 35 years. From the standpoint of long-term investors and lenders, it should be reassuring to see that the target market only gets larger—so there will be ongoing demand for projects created today. In fact, the U.S. Bureau of the Census projects that the number of people between 75 and 84 will increase by 60 percent over the next 35 years, while growth in the 85 and over population will be an extraordinary 163 percent. Right now, just under 3 million Americans are 85 or over; by 2020, there will be more than 7 million—and the vast majority will be single-person households, many of whom prefer or need some of the services provided in rental retirement housing.

However, two cautionary notes are in order:

- The lion's share of these increases that are frequently ballyhooed will not come to pass until the post-World War II baby boom generation become seniors. Someone born at the beginning of the baby boom will not be 65 until the year 2011, so other sources of demand will have to be relied upon for the next 25 years or so.
- The baby bust generation of the 1920s and 1930s is just reaching the age of 65 or so now. As a result, for example, the number of persons age 65 to 74 is projected to actually decline slightly during the 1990s. It is vital to see where within the widely diverse senior spectrum a given development is targeted and examine the demographics of that specific segment, rather than assume that the overall growth numbers assure success.



[illegible] a [illegible] amount of home equity that can be freed up by those choosing to move to rental housing.”

Today's living arrangements

As shown in Figure 3, there are marked differences in the living arrangements of older men and women, in part because there are only two-thirds as many men as women who are 65 or over:

- Less than 15 percent of the men live alone, compared with 40 percent of the women.
- Men are almost twice as likely to live with their spouses. (Some reports indicate that those men who move into a retirement community single are likely to be remarried within a year or two anyway.)
- In contrast, women are twice as likely to share a home or apartment with a non-spouse—usually another older woman or a relative.
- Only about 5 percent of all seniors live in nursing homes or personal care facilities.
- Household composition shifts with the advancement of age. In the early 1960s age group, almost two-thirds of the households are married couples. For 75 and over households, the proportion is down to one-third.

Very often, it is when a spouse dies or one spouse slows down considerably that an older person seriously considers making a change in living arrangements—from a larger home or apartment to a smaller unit that requires less maintenance and provides more security and less isolation.

This pattern is graphically portrayed in Figure 4, where homeownership rates are shown to decline beginning at age 65. In 1984, 80 percent of the households in the 55 to 64 age bracket owned their own homes. For households age 75 or over, the figure was 71.5 percent. These numbers suggest two important points relevant to rental retirement housing. The first is that eight out of ten older households either own homes or have sold their homes since retirement. Upon sale of a home, considerable equity can be captured and invested to produce supplementary income.

The second observation is that most elderly households own their own dwelling units and, if other alternatives for independent living were better known, might consider switching from ownership to rental. To date, there have been few options widely available that provide for independent living but offer such services as meals, transportation, recreation and housekeeping, if needed or desired.

Independence versus dependency

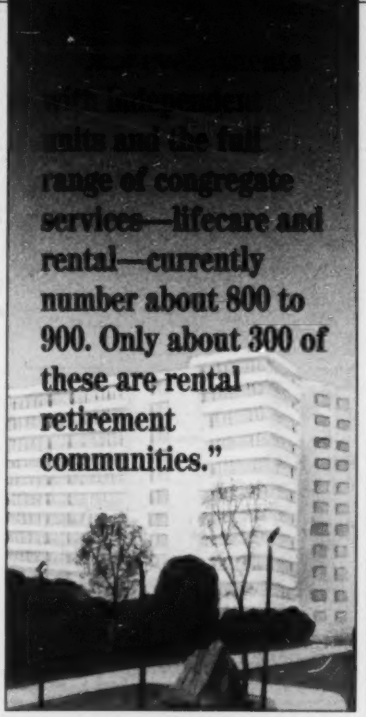
Life expectancies of older Americans have been increasing steadily, so that an average 75-year-old can expect to live many more years. While life expectancy keeps stretching out, the need for assistance in daily living tends to become greater as people age. In fact, the probability of a person requiring some assistance approximately doubles in each five-year period after 65.

While relatively few elderly Americans ever live in nursing homes, many do eventually need some additional services, while living independently in homes or apartments. Today's rental retirement housing offers services to such households—and for people who are now independent, provides the security of knowing that the services are available and can be used if needed.

continued

Migration of seniors

Contrary to popular opinion, senior citizens are not a mobile group. From 1982 to 1983, 7.3 percent of all owner-occupants in the U.S. moved—but the rate for households over 65 was only 2.2 percent. Among all renters, 32 percent moved—but among renter households over 65, only 8.6 percent moved. As suggested by these numbers, seniors are a far more stable tenant group than younger people. Once settled, older households tend to stay put. However, as would be expected, a decision to move also occasions long and careful deliberation, so lease-up of rental retirement housing is often slower than anticipated by developers lacking experience in senior housing. Between 1980 and 1983, 85 percent of Americans over 65 did not move at all. Of those who did move, 61 percent stayed in the same county, 21 percent moved to a different county but remained in the same state and only 19 percent of the small number of movers (3 percent of all seniors) went to a different state (and many of these were moving back to their home areas or to places close to their families).



[illegible] with independent units and the full range of congregate services—lifecare and rental—currently number about 800 to 900. Only about 300 of these are rental retirement communities."

Older people generally prefer to stay in the cities—and the neighborhoods—with which they are familiar. Being near friends and particularly family members becomes more important the older one gets. Consequently, rental retirement developments draw the bulk of their tenants from within a 10-mile radius. Depending on the region of the country, though, 10 percent to 20 percent of the residents, and sometimes even more, come from farther away, often to be closer to their children; many of these seniors earlier moved to the Sunbelt and are moving back after one spouse slows down or dies.

Income and home equity of seniors

Although market-rate rental retirement housing is not inexpensive, many seniors *can* afford these developments. The income and assets of many of today's older households are far greater than is commonly assumed. Moreover, elderly households hold a massive amount of home equity—a fact of particular significance because most residents of rental retirement housing previously owned their own homes, frequently free and clear.

Income diversity is common to households in all age groups—seniors included. Although many seniors have relatively modest cash incomes, even these households are more prosperous than their counterparts a few years ago. As the left side of Figure 9 shows, over one-third of households 70 and over—4.5 million households—have cash incomes of $15,000 or more. Another 3.2 million households age 65 to 69 also have incomes in this range. The median cash income of senior households increased by a startling 75 percent (in constant dollars) between 1962 and 1984.

Furthermore, as shown in Figure 6, seniors have close to $800 billion in total home equity, with 60 percent held by households age 70 and over. The average owner 65 or over has

continued

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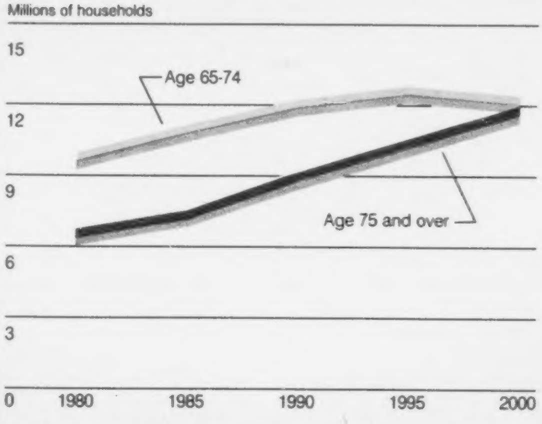
FIGURE 1

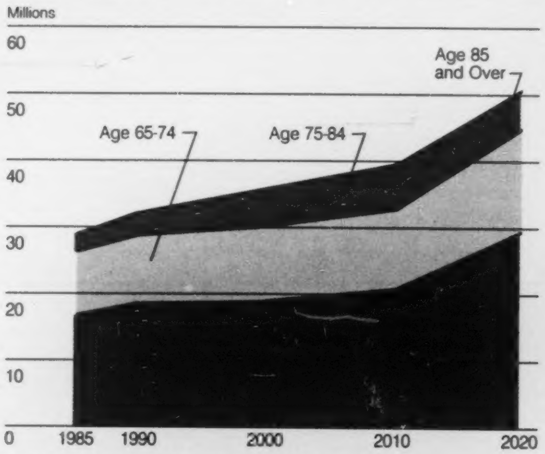
Projected Growth in Senior Households, 1980-2000



SOURCE: Calculations by Joint Center for Housing Studies of M.I.T. and Harvard University, based on cohort projections prepared by John Pitkin and George Masnick for U.S. Department of Housing and Urban Development.

FIGURE 2

Projected Growth in Senior Population, 1985-2020



SOURCE: U.S. Bureau of the Census (middle projections).

$60,900 in home equity. If this average household sold its home and invested the net proceeds at, say, 10 percent per year, it would have an additional $470 per month available to spend for multiservice rental housing. The right side of Figure 9 shows the results of adding potential income from home equity to cash income. Fully 49 percent of households 70 and over—6.1 million households—have potential incomes of $15,000 or more and 2.9 million have potential incomes of $25,000 or more.

Assumptions about elderly incomes are untrue

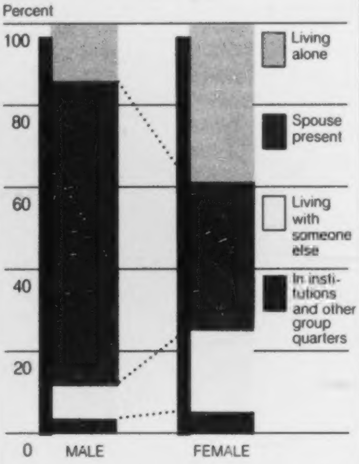
As a result of several phenomena—social security payments that have increased much faster than wage levels and continue to be indexed to inflation, improved and more widespread pension plans and greater accumulation of financial assets—a number of common assumptions about the elderly are inconsistent with the following realities:

- The percentage of persons who are poor is lower for people 65 and over than for those under 65, although this is partially because so many children live in poverty.
- The economic status of seniors is not much different from that of the population as a whole. Seniors' average after-tax income per household member is actually 9 percent higher

continued

FIGURE 3

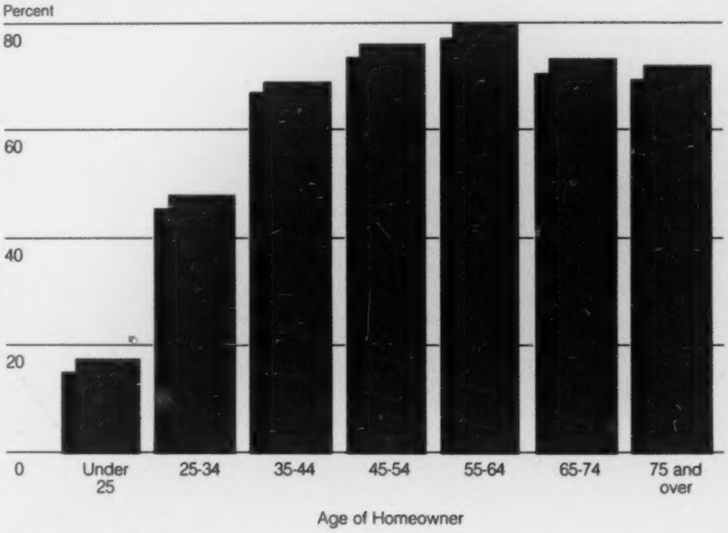
Living Arrangements of Men and Women Age 65 and Over, 1981



SOURCE: U.S. Bureau of the Census, Demographic and Socioeconomic Aspects of Aging in the United States.

FIGURE 4

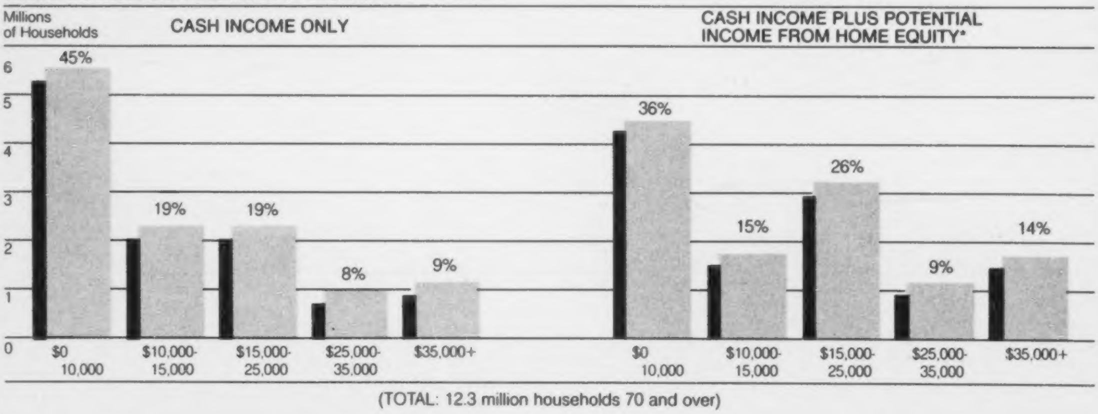
Homeownership by Age, 1984



SOURCE: U.S. Bureau of the Census.

Figure 5

Income Distribution of Households 70 and Over



*Assuming homes were sold and net proceeds of sale invested at 10% per year.

SOURCES: U.S. Census Bureau (special tabulation by Conference Board); RERC analysis of data from Susan Wachter, University of Pennsylvania, *Housing Demand Analysis*, forthcoming, based upon 1983 Survey of Consumer Finances.

than that of non-seniors.

- Most senior households are not living on "fixed incomes." Careful studies indicate that, if anything, their incomes are more protected against inflation than the incomes of younger households.
- Despite the perception that retirees have to live much more frugally than they did when they were working, more than 80 percent of retirees have the resources to consume at the same rate during retirement as they could before they retired.
- Not all seniors are retired, so some households still receive significant income from earnings; many receive income from investments.

Seniors can afford multiservice housing

The facts show that many seniors *can* afford a rental retirement housing package, including services, in a price range of $700 to $2,500 per month. Not only do a large number of senior households have relatively high incomes, particularly after adding potential income from home equity; they also benefit from having a comparatively high proportion of their income available for housing because many of their other expenses are lower than when they were younger. Many non-housing expense items—such as food, transportation, utilities, major appliances, housekeeping, linens and entertainment—are fully or partially included in the rental retirement package.

To develop the data in Figure 7, Real Estate Research Corporation (RERC) calculated the percentage of income that households at various age and income levels are already spending for items typically covered by a rental retirement package; these funds would clearly be available after a move to this type of development. In addition, it was assumed that much of the money now being saved (often because housing costs are so low for

continued

Figure 6

HOME EQUITY OF SENIORS*
(1985 Dollars)

Age of household head	Total home equity	Average equity per owner household
65-69	$306.8 billion	$69,700
70-74	$196.6 billion	$57,800
75+	$271.3 billion	$55,100
	$774.7 billion	$60,900

*Excluding those with negative equity.
SOURCE: Real Estate Research Corporation analysis of data from Susan Wachter, University of Pennsylvania.

Figure 7

Households That Can Afford Various Levels of Monthly Payments, 1985

	Households that can afford monthly payment* or more than:			
	$800	$1000	$1500	$1800
One-person households				
65-69	1,062,000	794,000	428,000	222,000
70-74	905,000	518,000	197,000	128,000
75 and over	1,446,000	885,000	390,000	340,000
Subtotal	3,413,000	2,197,000	1,015,000	690,000
Two-person households				
65-69	2,272,000	1,797,000	876,000	611,000
70-74	1,569,000	1,249,000	484,000	320,000
75 and over	1,943,000	1,678,000	737,000	725,000
Subtotal	5,784,000	4,724,000	2,097,000	1,656,000
TOTAL 65 AND OVER	9,197,000	6,921,000	3,112,000	2,346,000
Households that can afford payments as percentage of total households (by age group)				
65 and over	51%	38%	17%	13%
70 and over	48%	35%	15%	12%
75 and over	46%	35%	15%	15%

*Including one meal per day, utilities, linen service, transportation, housekeeping, etc.
Proceeds from home equity assumed to be invested at 10%.
SOURCE: Real Estate Research Corporation analysis of data from Susan Wachter, University of Pennsylvania.

those owning a house free and clear) would also be available if a household wanted to move into a rental retirement community. These calculations generally indicate that 50 percent to 58 percent of income (depending on age and income level) could be spent for a typical package that includes one meal per day. For households that own homes, RERC then added the potential income from investing the net proceeds from home sales.

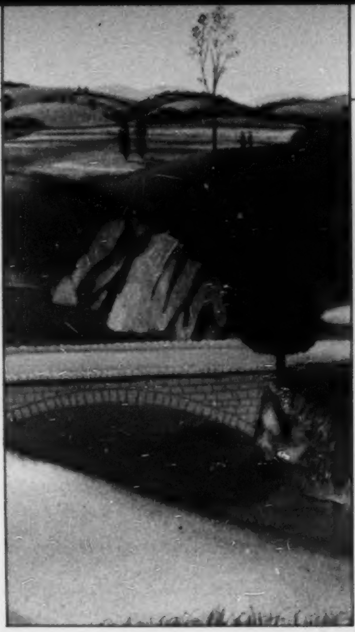
Figure 7 shows that, for example, 2.4 million one-person households 70 and over can afford a monthly payment of $800 or more. Among two-person households, 2.9 million can afford a monthly payment of $1,000 or more. Fully 46 percent of all households 70 and over (5.7 million) can afford some form of rental retirement housing (given that monthly costs at less expensive developments generally start at about $750 for one person and $900 for two persons).

Many of the more desirable rental retirement communities have substantially higher monthly charges—particularly those that are newer, are in high-cost areas or provide higher quality or more comprehensive services or larger units. More than 1.6 million households age 70 and over can afford monthly payments of more than $1,500 for one-person households or $1,800 for two-person households. The potential market becomes even larger, of course, if households age 65 to 69 are also considered.

Prospects for the future

Not only are these figures substantial, but they will be increasing significantly during coming years. This is due not only to the rapid rate of growth in the number of senior households, but also that most key sources of senior income will be increasing over time:

- Social security has become almost universal among those over 65 and is basically inflation-proof.
- The assets of seniors—and income from those assets—will continue to grow.
- Pension provisions are improving and benefits will be larger and more widespread for future retirees than they are for current seniors.



Even if the distribution of income and home equity remains constant, future increases in the number of senior households will boost the number of households 70 and over that can afford one or more types of rental retirement housing from 5.7 million in 1985 to approximately 7.6 million in the year 1995. In fact, the growth will be even greater than this because income and home equity will be significantly greater in 1995 than they are today (in constant dollars). If forecasts of elderly income are correct, approximately 87.8 million households 70 and over will be able to afford this type of living in 1995, a 54 percent increase over 1985.

Key factors to watch for

An intensely service-oriented real estate product like rental retirement housing must be of consistently high quality. Not only is this required for the success of individual projects; a highly publicized catastrophe in a particular metropolitan area would likely impede marketing of other developments in the same market. As a result, it is important to emphasize the key variables of successful development:

Front-end costs:

- Lenders are demanding sophisticated market analyses for rental retirement developments. Elderly populations vary enormously from one market to another, in terms of size, income level, attitudes and many other variables and development potential is strongly influenced by such factors as locational amenities and proximity to shopping areas. Moreover, as competition is increasing, market segmentation is becoming more refined. RERC has created a sophisticated computer model that estimates the demand for rental retirement housing in any given market area.
- Absorption that is slower than for traditional rental projects must be anticipated in cash flow planning. An overall absorption rate of 10 units a month is very successful and five to seven per month is more typical. It is not unusual for potential residents to make five or more visits before making a decision—children and friends are often brought along as advisors. In addition, marketing efforts must recognize that most potential residents are not specifically in the market for rental retirement housing and may not yet appreciate its advantages. Marketing efforts prior to opening are important, in part to familiarize nearby seniors and their families with a new development, although most leases are not signed until construction is completed.
- Marketing efforts should strive to establish the credibility of a development and the developer, by means of community outreach and association with known service providers. Marketing for rental retirement developments is much more expensive than for traditional developments.
- Despite the large need for additional developments, it would not be difficult to saturate any particular market, as is occurring in a number of areas, given the intense developer interest in tapping this demand and the comparatively slow absorption experienced even when there is limited competition.
- Virtually every rental retirement development necessitates rezoning or obtaining variances. Some states have also begun to require licensing of rental retirement housing even when a nursing home is not included. Again, these requirements can consume time and money and must be anticipated.

Service provision:

- Service is crucial to ongoing success, which makes these developments distinctly different from normal housing projects. Over the years, many organizations and individuals have learned how to provide effective services for the elderly; the key is to be sure that staff or contracted service providers are experienced in this field.

- Good food service is critical. Tenants will move out if the food is not good, the service poor or the setting unappealing.
- Social and recreational activities are also important and should be tailored to the sociological profile of the tenants. Inclusion of active recreational facilities can increase the appeal to the younger end of the market.

Design and location:

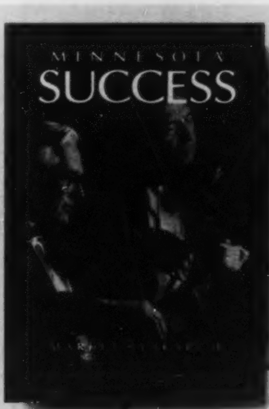
- Experience with the elderly must be reflected in project design. Consideration should be given to such factors as color perception; kitchen and bathroom accommodation and door widths for partial handicaps; accessibility and lighting; indoor and outdoor security; size of units (larger units are more popular than smaller and efficiencies are often hard to market); size of congregate kitchens and dining rooms; and provision of a good-sized multipurpose room and other activity areas. Esthetically, developments should look like quality residential communities, not institutional nursing homes.
- Many residents own cars even if they use them very little. So adequate parking must be provided. Similarly, storage space outside the individual apartments should be made available.
- A well-planned and attractive entrance to the complex is extremely desirable from both marketing and tenant satisfaction perspectives.
- Locational features, such as a low neighborhood crime rate and proximity to shopping, public transportation and potential residents and their families are also important.

Management:

- Because of the extensive service provision, far more demands are placed on managers than in the typical apartment project. Numerous vendors and a range of service staff have to be dealt with on a daily basis.
- Experience with and sensitivity toward seniors are essential. These qualities should be reflected in careful health screening of prospective tenants and appropriate procedures for dealing with residents who need more intensive assistance than the development provides. The age profile of a project will change over time, so management has to be adaptable.

These complexities add to development risk. Relative to the traditional multifamily development that does not include an array of services, a well-designed, well-managed rental retirement project also offers an opportunity for higher financial return. Achievable rents are much less sensitive to those being charged at nearby developments and the higher monthly charges can make it possible to include a somewhat higher profit factor.

Many senior households can now afford rental retirement housing. The market will expand significantly as the number of relatively affluent seniors grows and as the concept becomes more widespread and better known. Developments that are located, designed and marketed well and that include quality management and services sensitive to the particular needs of seniors, offer excellent potential for investment. ☐



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MORTGAGE MARKET TRENDS

The first of this year ended on a weak note as GNP growth slowed to a 1.1 percent annual rate in the second quarter, down from a 3.8 percent rate in the first quarter. While the second quarter calculation of GNP is subject to change in the coming months, overall economic activity was, nevertheless, substantially lower in the second quarter than in the first.

A part of the reason for the second quarter decline in GNP growth was slower than expected auto buying in the first quarter, which left manufacturers with a large inventory of unsold cars. A dip in the production of autos during the second quarter pared auto inventories such that nonfarm inventory investment declined by $25 billion in the second quarter, after a $21 billion increase in the first. A further constraint to higher growth during the second quarter was imposed by the continued decline in oil and gas exploration, initiated by the free fall in world oil prices.

There were, however, a few rays of good news during the second quarter. Producer's durable equipment purchases rose considerably, up $12.5 billion following a drop of almost $15 billion in the first quarter. Government spending also played a positive role in the second quarter. There was continued strength in consumers' spending during the second quarter. Purchases of durable goods by consumers reversed a first quarter decline of $1.6 billion, rising $12 billion in the second quarter, and nondurable goods purchases maintained its first quarter vigor. Spurred by low interest rates, residential construction showed a very favorable performance, adding almost $7 billion to annual GNP growth during the second quarter, compared to about $5 billion in the first. Additionally, inflation has shown few signs of any meaningful resurgence.

The primary restrictions on growth in the first half are now behind us for the most part. The excess inventories of autos have largely been depleted, and the steep decline in oil and gas exploration resulting from the precipitous drop in oil prices has probably bottomed out. However, it is unlikely that consumer spending will continue at its first half pace; and some fundamental weaknesses still stand in the way of any substantial resurgence in the pace of overall economic activity for the near term.

One major area of underlying weakness in the economy important to second half growth is business fixed investment. The effect of intense and prolonged foreign competition on domestic producers has been to idle large portions of plant and equipment. This, in turn, has dampened investment demand in that sector. In addition, high vacancy rates coupled with some sharp downturns in local economies have produced a steep reduction in the construction of commercial buildings since early this year. The potential for revisions in the tax structure as it effects these structures will further act as a drag on nonresidential investment throughout the remainder of the year. Moreover, growth in producers durable equipment during 1986, previously stimulated by demand for high technology capital, may be less than was the case in 1985.

A second major area of weakness in the economy is the continued deterioration in the foreign trade deficit. The dollar's decline in exchange markets has stimulated a positive response in the volume of nonfarm exports, but imports continue unabated. Between the fourth quarter of 1985 and the second quarter of 1986, nonfarm exports rose at an annual rate of 9 percent. But during the same period, imports of nonoil items rose at an 11 percent rate. Changes in the exchange value of the dollar have not been translated into lower imports to the degree originally expected. Apparently, foreign producers have, to date, been less sensitive to profit margins than to market share.

Prospects for a resurgence of economic growth in the second half of this year are also dimmed by expectations of more fiscal restraint, resulting from the Gramm-Rudman deficit target of $144 billion. While this goal may not actually be met, there is little doubt that the fiscal 1987 deficit will be lower than the prospective fiscal 1986 deficit of about $220 billion. Irrespective of long run benefits, Federal spending restraints will contribute to a weakening in the second half levels.

All in all, economic performance in the second half of this year should be fairly moderate, but better than the 2.5 percent rate of growth in the first half. There is evidence to suggest that the factors acting as a drag on activity during the first half of the year are slowly ending. Imports of petroleum products have been running at an unsustainable rate, and high oil inventories should discourage any further pickup in oil imports. Moreover, the rate of business inventory investment, freed from the excess auto stocks, will probably be a net addition to growth in the second half.

Given the prospect for moderate growth during the remainder of the year, the Federal Reserve is, nevertheless, unlikely to attempt to stimulate economic activity in an aggressive fashion. Any further declines in interest rates would have only marginal impact on domestic output, and could precipitate an increase in the volume of nonoil imports. The Fed must also be concerned about the debt service requirements of developing countries, and the potential for major disturbances a repudiation of debt would invariably produce.

The housing market, on the other hand, should continue to show a solid performance in the second half of this year. Mortgage interest rates should remain near current levels, and may even fall a bit further in the coming months. The fundamentals on inflation also continue to look good. Demand for single-family homes should remain firm. Given the outlook for interest rates, new home sales may run at an annual rate of 750,000 to 800,000 unit level, with existing home sales near 3½ million. New construction of multifamily buildings may be buffeted by some regional economic problems and prospective changes in the tax code, but an annual rate of multifamily housing starts of between 550 and 600 thousand units for the second half is not unlikely. Starts on single-family homes should behave quite well, however, with sales of homes generating residential starts at about a 1¼ million annual rate through the remainder of 1986. And, unless a drastic change in mortgage rates occurs, this level of activity implies total mortgage originations of approximately $400 billion for 1986, with about 35 to 40 percent of activity accounted for by refinancing of outstanding loans.

Gregory D. Luetscher, *Economist*
August 12, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS						PERMITS 17,000 ISSUING PLACES					
	Actual			Seasonally Adjusted Annual Rates			Actual			Seasonally Adjusted Annual Rates		
	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986												
JAN	116	79	37	2,034	1,442	592	119	74	45	1,861	1,187	674
FEB	107	71	36	2,001	1,317	684	109	68	41	1,808	1,155	653
MAR	151	104	47	1,960	1,305	655	152	99	53	1,834	1,150	684
APR	188	126	62	2,019	1,321	698	180	125	55	1,885	1,256	629
MAY	187	134	53	1,860	1,330	530	170	120	50	1,788	1,210	578
JUN	183	131	52	1,845	1,301	544	169	118	51	1,745	1,193	552
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
6 MONTHS												
1986	932	645	287				903	604	299			
1985	855	582	273				843	540	303			
1984	914	631	283				899	578	321			
1983	806	577	229				775	517	258			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS								PERMITS 17,000 ISSUING PLACES							
	Actual				Seasonally Adjusted Annual Rates				Actual				Seasonally Adjusted Annual Rates			
	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West	North East	Mid-West	South	West
1986																
JAN	14	10	62	29	350	318	909	457	14	12	58	34	290	314	767	490
FEB	12	11	51	33	404	370	745	482	12	12	53	32	287	306	743	472
MAR	21	21	69	40	332	344	763	521	21	20	64	46	276	287	718	553
APR	29	32	75	51	324	365	796	534	29	33	69	49	302	333	727	523
MAY	27	28	79	53	260	252	823	525	29	31	62	49	277	301	687	523
JUN	30	35	70	48	290	298	765	504	27	29	64	48	271	280	701	483
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
6 MONTHS																
1986	133	137	406	255					133	136	373	260				
1985	110	109	400	236					122	105	378	238				
1984	86	115	478	236					92	103	451	253				
1983	75	95	456	182					72	84	432	187				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
JAN	213	55	351	6.0	$224.0	$92.9	$29.9	$101.2	1,094	628	466	122	81	41
FEB	218	59	342	5.9	225.1	94.8	29.8	100.5	1,110	638	472	118	76	42
MAR	277	89	331	4.5	221.1	95.7	30.8	94.6	1,099	627	472	133	92	41
APR	336	84	334	4.5	224.4	97.5	31.8	96.1	1,135	641	494	129	94	35
MAY	330	74	340	5.4	224.2	99.5	33.0	91.7	1,135	650	485	147	94	53
JUN$_p$	339	64	345	6.1	226.8	102.2	34.1	90.5	1,159	667	492	147	101	46
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
6 MONTHS														
1986	1,713	425										796	538	258
1985	1,522	360										788	531	257
1984	1,494	351										767	521	246
1983	1,337	329										529	378	151

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED

By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
OCT	$36,525	$6,548	$14,014	$13,288	$2,675	$24,450	$6,104	$11,032	$7,208	$106
NOV	32,864	5,660	12,363	11,886	2,955	21,142	5,200	9,357	6,491	94
DEC	43,586	5,730	15,919	16,189	5,748	22,814	5,158	10,101	7,162	393
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR$_p$	34,734	8,906	13,190	10,197	2,441	25,772	8,134	10,348	6,949	341
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
3 MONTHS										
1986	87,744	20,229	34,180	27,609	5,726	62,093	18,628	26,398	16,493	574
1985	66,722	12,621	26,703	23,026	4,372	42,999	11,594	19,227	11,985	193
1984	65,427	13,947	25,697	22,966	2,817	44,430	13,038	18,977	12,240	175
1983	52,965	14,395	17,422	18,322	2,826	38,693	13,520	13,444	11,577	152

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS					NONRESIDENTIAL				
	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.
1985										
OCT	$2,694	$150	$1,456	$700	$388	$9,381	$294	$1,526	$5,380	$2,181
NOV	2,545	183	1,401	716	245	9,137	277	1,605	4,639	2,616
DEC	5,048	274	2,935	1,111	728	15,724	298	2,883	7,916	4,627
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR$_p$	2,215	300	1,278	446	191	6,747	472	1,564	2,802	1,909
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
3 MONTHS										
1986	6,340	709	3,595	1,420	616	19,311	892	4,187	9,696	4,536
1985	5,079	584	2,776	1,307	412	18,644	443	4,700	9,734	3,767
1984	4,798	172	2,729	1,609	288	16,199	737	3,991	9,117	2,354
1983	3,040	191	1,589	1,050	210	11,232	684	2,389	5,695	2,464

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH					OUTSTANDING				
	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.	Total	Mtg. Bankers^9	S&Ls	Banks^2	Life Cos.
1985										
OCT	$29,039	$4,208	$16,134	$5,775	$2,922	$110,307	$12,436	$49,882	$29,100	$18,889
NOV	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
DEC	28,511	6,489	14,889	4,693	2,440	109,632	14,091	47,704	31,459	16,378
1986										
JAN	24,619	7,695	12,913	1,588	2,423	96,650	13,930	47,353	18,327	17,040
FEB	31,258	7,954	13,907	6,806	2,591	108,898	16,153	44,355	30,732	17,658
MAR$_p$	40,249	14,666	17,787	3,372	4,424	118,879	23,110	50,614	25,946	19,209
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
3 MONTHS										
1986	96,125	30,315	44,607	11,765	9,438					
1985	60,261	9,966	33,988	8,946	7,361					
1984	61,573	12,569	32,604	10,884	5,516					
1983	51,252	17,481	23,117	7,086	3,568					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units)				LOANS INSURED							
	Total	FHA^3	VA	Private	Total		FHA(203)		VA		Private	
					Units	Amt.	Units	Amt.	Units	Amt.	Units	Amt.
1986												
JAN	205	130	24	51	110	$7,298	45	$2,659	19	$1,304	46	$3,335
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	305	211	33	61	115	7,752	57	3,477	23	1,621	35	2,654
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
JUN$_p$	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
6 MONTHS												
1986	1,758	1,133	201	424	706	48,739	323	19,986	134	9,605	249	19,148
1985	1,017	396	103	518	579	37,447	149	8,518	79	5,189	351	23,740
1984	994	243	113	638	710	45,335	123	6,535	116	7,450	471	31,350
1983	703	158	180	365	527	30,883	174	8,505	120	7,477	233	14,901

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities		Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued					Applications	Issued
1986										
JAN	$1,315	$1,188	$58,391	$3,964	$4,880	$5,305	$3,709	$3,300	$10,103	$5,298
FEB	2,578	1,159	60,752	2,978	5,526	6,044	4,605	4,268	5,973	5,006
MAR	1,917	1,410	62,310	2,260	7,213	7,128	5,318	5,900	14,853	5,059
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAY	3,538	1,978	67,312	4,491	9,857	10,612	8,947	8,162	4,863	5,872
JUN[p]	3,049	3,000	72,377	6,831	n.a.	n.a.	n.a.	n.a.	9,472	8,178
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
6 MONTHS										
1986	16,171	10,366	—	23,359	35,699	38,958	28,774	27,223	58,600	36,313
1985	10,418	10,880	—	8,200	18,019	19,181	14,468	13,738	24,139	17,888
1984	10,118	9,185	—	5,416	7,652	8,396	6,067	5,464	19,004	15,264
1983	9,038	8,988	—	7,387	8,281	9,772	10,193	8,799	37,950	25,781

* Year-to-date totals are for five months only

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA	CONVENTIONAL		CONVENTIONAL		1 Yr. ARM (1%/Yr.)	FRM Conv.	
	NEW[4]	New	Existing	New	Existing			
1986								
FEB	10.59%	10.49%	10.50%	10.68%	10.83%	9.89%	10.269%	11.63%
MAR	9.77	10.06	10.10	10.50	10.62	9.04	9.494	11.09
APR	9.80	9.99	9.99	10.27	10.37	8.49	9.300	10.84
MAY	10.07	10.32	10.33	10.22	10.15	8.70	9.663	10.81
JUN	9.98	10.38	10.39	10.15	10.20	8.60	10.050	11.62
JUL[p]	n.a.	n.a.	n.a.	10.32	10.28	8.29	9.813	12.02

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
FEB	9.75%	9.90%	9.95%	10.21%	8.70%	7.11%	7.63%
MAR	9.05	9.23	9.27	9.41	7.78	6.57	7.20
APR	9.01	9.08	9.12	9.26	7.30	6.08	6.60
MAY	9.33	n.a.	n.a.	9.50	7.71	6.19	6.62
JUN	9.59	9.51	9.54	9.65	7.80	6.27	6.71
JUL	9.32	9.48	9.49	9.57	7.30	5.86	6.33

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
FEB	38	105	120	125
MAR	36	127	145	149
APR	54	171	178	182
MAY	57	162	n.a.	n.a.
JUN	41	179	171	174
JUL	n.a.	202	218	219

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,000	1,280	[illegible]	2,120	80	0	80	1,000	[illegible]	[illegible]	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
YEAR AND MONTH	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,400	4,000	430	[illegible]	4,000	3,310	80	[illegible]	[illegible]	100	750	7,810	[illegible]	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

		1-4 Units				5+ Units			
YEAR AND MONTH	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,080	1,500	[illegible]	3,610	170	0	170	[illegible]

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	58	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,660	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.

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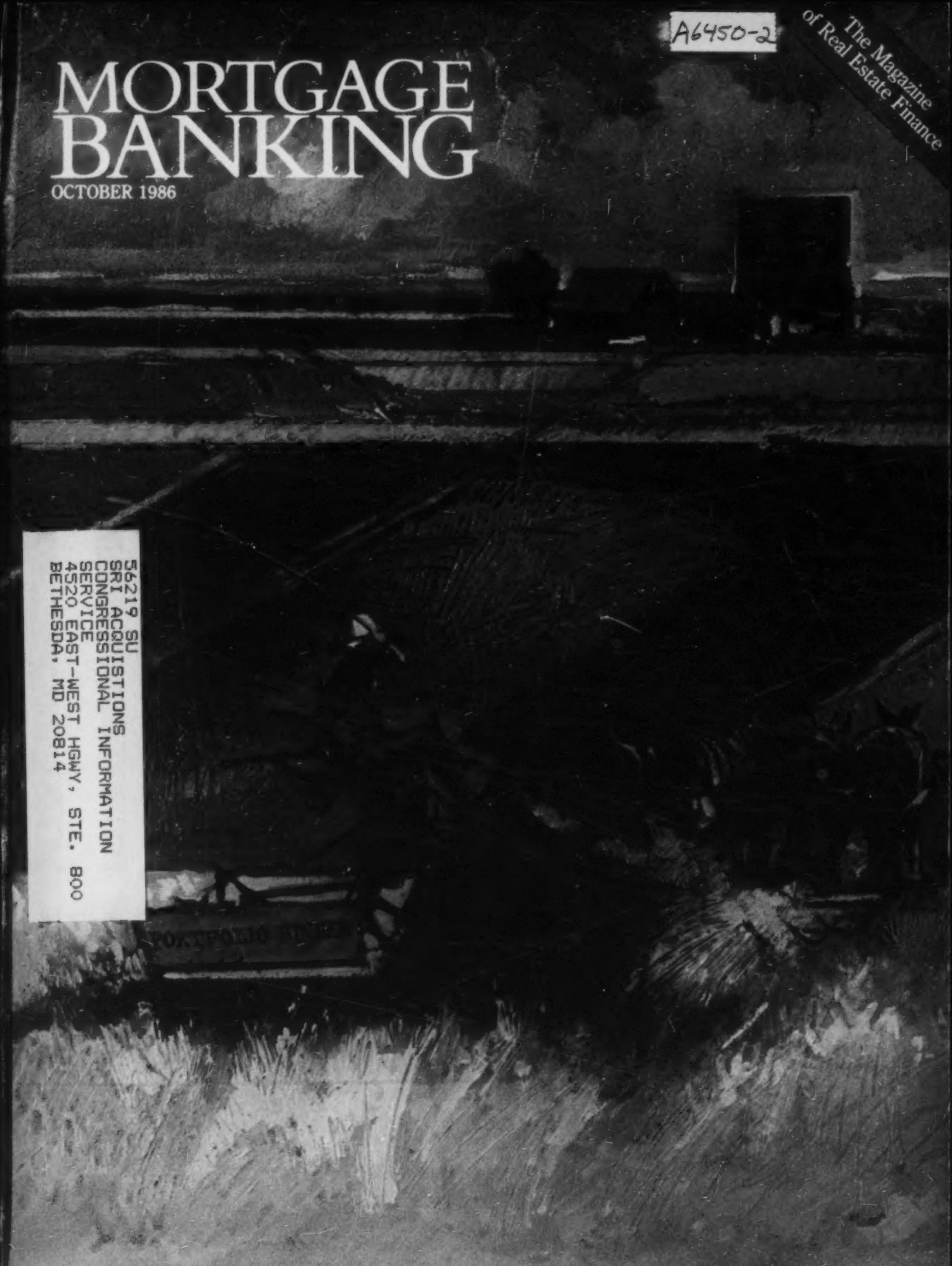
MORTGAGE BANKING

OCTOBER 1986

The Magazine of Real Estate Finance



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MORTGAGE BANKING

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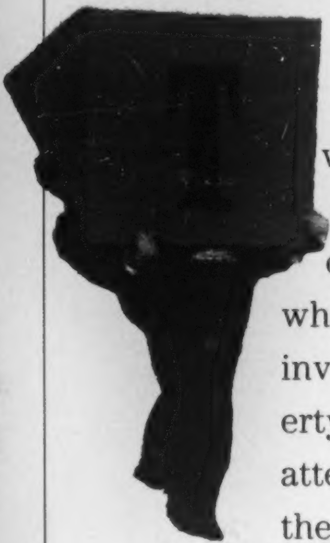
Eric Stevenson

TURNING THE PIECES INTO SECURITIES

Income Property Mortgages



Two and a half years ago, the Canadian developer, Olympia & York, financed three existing New York office buildings by issuing $970 million in securities, which Salomon Brothers then sold to approximately 45 investors. It was not the first securitized income property mortgage but its size and novelty attracted national attention. In the time period since then, an increasing volume of income property mortgages has been turned into securities. It is now possible to categorize different types of income property (often called "commercial") mortgage-backed securities. (Charts 1 and 2 list many of the major transactions.) The categories are significantly different from one another, but each, in its own way, is important for mortgage bankers and lenders to understand.

The types of securities covered in Charts 1 and 2 have been developed during the past two or three years, but securitization of income property mortgages in other forms has been in existence for at least 15 years.

One example is the project loans insured by the Federal Housing Administration (FHA) for multifamily buildings and for hospitals and nursing homes. The Government National Mortgage Association (Ginnie Mae) guarantees the timely payment of principal and interest for the securi-

ILLUSTRATION BY STEVE McCRACKEN

ties backed by the mortgage pool, which consists of one project loan per pool and the securities are sold in the same manner as Ginnie Mae-backed single-family mortgage securities are sold.

A second familiar example of securitization is the use of tax-exempt bonds to finance commercial and residential properties. The bonds are often backed by a lease from a credit-rated tenant, by a letter of credit from a credit-rated bank or by credit support from a surety.

The third use of securities during the last five years is the situation when a financial institution sells its building (usually its headquarters) and leases it back over a long-term lease. The sale is financed by the issuance of securities backed by a mortgage and the securities are as strong as the credit of the tenant under the long-term lease.

Sale-leaseback financing may consist of one interest bearing note or several classes of notes. For example, with a building costing approximately $180 million in 1983 that was leased by a major life insurance company, the class of securities with the shortest term, five years, received its principal repayments before any part of the next shortest term securities were repaid. These, in turn, were retired before principal payments were made on the third class of 15-year notes.

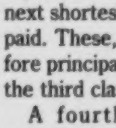
A fourth familiar method of securitization is used by the real estate investment trusts (REITs) that invest in mortgages. The REITs must distribute almost all of the income received from the mortgages to their shareholders.

Finally, syndications, which are shares in limited partnerships, have been selling shares both in equity ownership of real estate and in mortgage loans. Shares may be sold privately or in the public market.

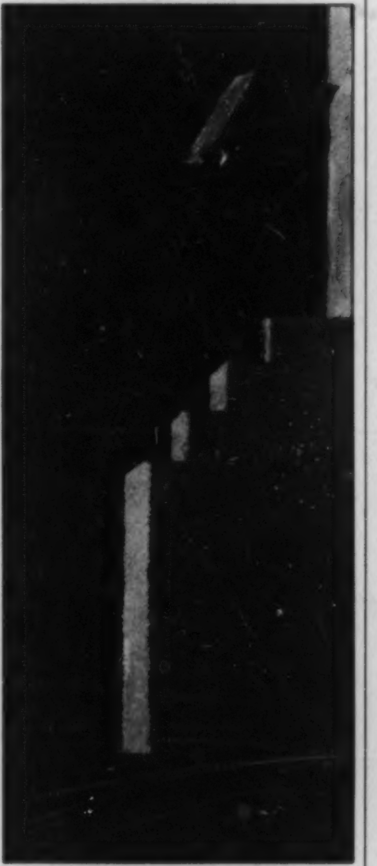
New categories of securitization

There are two distinctly different types of securitization that are relatively new to the income property field. The first is the act of financing, through the use of securities, one or more income properties owned by one owner. This category may be called "securitized originations." (Some of the major deals are listed in Chart 1.)

The second category consists of turning a portfolio of existing mortgages owned by one lending institution into securities for the purpose of sale or to use as collateral for borrowing. This category, covered in Chart 2, can be called "securitization of existing portfolios."



Eric Stevenson is senior staff vice president of income property at the Mortgage Bankers Association of America. He is also the author of the MBA handbook on The Secondary Market and Securitization for Income Property Mortgages.



Related to the "securitization of existing portfolios" are the programs of the Federal Home Loan Mortgage Corporation (Freddie Mac) and the Federal National Mortgage Association (Fannie Mae) to purchase or swap multifamily housing mortgages on a continuing basis. The mortgages are then pooled and participation certificates, which are mortgage-backed securities, are sold.

Securitized originations

The chief characteristic of a financing or refinancing that is handled through the securities market is its size, usually more than $100 million. The largest "origination" is the $1.3 billion financing of the Rockefeller Center.

The transactions have been diverse. Some securities have been rated AA by Standard & Poor's Corporation; others have paid higher interest rates because of the perceived risk that the mortgage is backed either by raw land or by hotels and gambling casinos. Several securities issues have been used for financing of multiple properties, often in connection with an acquisition. In 1983, Drexel Burnham Lambert helped Melvin Simon, the shopping center developer, refinance nine shopping malls and provide construction financing for a tenth. When another shopping center developer, Alfred Taubman, acquired Woodward and Lothrop, the department store chain, the real estate was financed with securities underwritten by Salomon Brothers. Merrill Lynch Capital Markets assisted in the acquisition of Motel 6, a chain of budget motels, through mortgages converted to securities and Salomon Brothers used first mortgage securities for financing the sale of Holiday Inns in Virginia.

Major developers use the securities market because of their enormous need for funds. Olympia & York, for example, raised about $4 billion in 1985, using a variety of sources, including the mortgage market, the commercial paper market and the securities market for income property mortgages. Lincoln Properties borrowed nearly $2 billion in 1985, of which its securities issue of $148 million to finance two office buildings (one in Atlanta and one in Pittsburgh) was only a small part.

Standard & Poor's credit ratings

Standard & Poor's (S & P) issued guidelines in November 1984 for the procedures it would use to attach a credit rating to a pool of mortgages or to a mortgage on a particular piece of property. Mortgage bankers thought at the time that perhaps the credit ratings would be applied to pools of mortgages, which, with a rating, could be compared to rated corporate and municipal bonds. On the contrary, the five ratings prior to July 1986 are all

"There are two distinctly different types of securitization that are relatively new to the income property field."

on large New York office buildings.

In early August 1986, S & P rated its first multifamily issue. The AA minus rating followed guidelines issued in December 1985 for multifamily apartments.

To rate an income property mortgage, S & P uses a "worst case scenario." It estimates what might happen to rents and occupancy ratios if there were a "worst case," a severe recession in real estate. It calculates, under the worst case, what sums would be necessary to pay the debt service, maintain the loan-to-value ratio at a comfortable level and what kind of reserves would be necessary to provide liquidity.

The first mortgage with a credit rating was the zero coupon bond that financed part of the American Express building now going up in lower Manhattan. Notes with recourse to American Express had financed part of the $700 million building. The zero coupon bond was sold to raise $82 million, but when it was to be redeemed in approximately 15 years, the issuer would have to pay $450 million to the bondholders. It would apparently be sufficiently protected because by the time the zero coupon bond fell due, the recourse notes would have been paid and the zero bond would be a first lien on a building worth (in 1985) about $700 million.

For three other ratings of AA given by S & P on financing of New York office buildings, credit support from a third party was required. Olympia & York obtained limited guarantees from Aetna Casualty & Surety for

CHART 1 Securitized Originations (as of July 1, 1986)

The following list includes the majority of securitized originations. It includes both public sales and privately placed securities, but not participations nor does it include many securities on buildings leased by financial institutions.

Date	Issuer and type of property	Type of security	Amount
June 1983	MSA Shopping Malls, Inc. (10 shopping centers)	10.95% participating mortgage bonds with additional interest certificates	$110 million
March 1984	Olympia & York (3 New York office buildings)	Floating rate first mortgage notes	$970 million
April 1985	American Express (New York office building)	Guaranteed notes plus non-recourse zero coupon bond	$868 million
April 1985	Motel Acquisition Company, Inc. (Motel 6, a motel chain)	Adjustable rate pass-through certificates	$186 million
May 1985	Prime Motor Inns (43 motor hotels)	First mortgage certificate	$173.5 million
July 1985	VMS Realty (2 Philadelphia office bldgs.)	Two series of interest notes plus zero bond	$120 million
August 1985	Woodward & Lothrop (Department stores)	Subordinated notes: First mortgage notes	- $130 million - $127 million
1985	Fluor World Headquarters (Company headquarters in Irvine, California)	First mortgage certificates	$204 million
September 1985	Rockefeller Center Properties, Inc. (office buildings in New York)	Convertible debentures, Common stock, zero coupon bond	$1.3 billion
December 1985	Olympia & York Maiden Lane Finance Corporation (office buildings in New York)	First mortgage notes	$200 million
December 1985	Fisher Brothers Financial Realty (New York office building)	First mortgage notes	$160 million
December 1985	Lincoln Property Associates Limited (Atlanta and Pittsburgh office buildings)	First mortgage bonds	$146 million
March 1986	Las Colinas Corporation (797 acres of land)	First mortgage notes	$150 million
April 1986	Bally's Grand, Inc. (Two casino hotels)	First mortgage notes	$320 million
May 1986	Olympia & York Water Street Finance Corporation (New York office building)	Secured notes and zero coupon bond	$548 million
June 1986	Real-Vest Corporation (Los Angeles office building)	Serial mortgage notes	$198 million
June 1986	VMS Realty (Holiday Inns and Crowne Plaza Hotels)	First mortgage notes	$279 million

Note: Where zero coupon bonds are used, the total amount of financing listed in the chart includes the eventual payoff of the zero coupon bonds. For example, American Express received approximately $82 million from the sale of zero coupon bonds, but when the bonds fall due 15 years after issuance, it will owe $450 million.

CHART 2 Securitization of Existing Portfolios

A. Euromarket Offerings

Date	Issuer	Type of security	Amount
December 1984	Prudential Realty Securities III	Fixed payment bonds (2 classes plus zero)	$1.3 billion
January 1985	New England Life Mortgage Corporation	Fixed payment bonds (2 classes plus zero)	$299 million
August 1985	CM International, Inc. (subsidiary of Connecticut Mutual Life Insurance)	Fixed payment bonds (2 classes plus zero)	$344 million
August 1985	Phoenix Mutual Funding Corporation	Fixed payment bonds (2 classes)	$158 million
January 1986	Mutual Benefit Overseas Inc.	Fixed payment bonds (3 classes plus zero)	$856 million
B. Pass-Through Certificates			
April 1985	Lincoln Mutual Life Insurance Company	One pool	$ 94 million
May 1985	The Guardian Life Insurance Company of America	Four pools	$ 95 million
June 1985	The Travelers Insurance Company	One pool	$310 million
August 1985	The Massachusetts Mutual Life Insurance Company	Nine pools	$693 million
December 1985	Home Life Insurance Company	Five pools	$214 million
December 1985	The Equitable Life Assurance Society	Two pools	$156 million
July 1986	The Equitable Life Assurance Society	Three pools	$225 million
C. Commercial Mortgage Obligation			
December 1984	Penn Mutual	Three classes plus zero	$244 million
D. Freddie Mac			
1984	Two Swaps under Guarantor Program with Financial Corporation of America		$830 million (approx.)
1985-86	Three issues of multifamily mortgage participation certificates		$1.6 billion
E. Fannie Mae			
September 1984	MBS Swap with Midwest Federal		$140 million
1985	2 MBS Swaps with Seamens Savings Bank		$250 million
April 1986	MBS Swaps with Empire Savings, FSA		$108 million
F. Major Participations			
December 1985	Lincoln National Life Insurance	Sale of whole loans to First Boston, which sold participations	$140 million
June 1986	The Integon Corporation	Sale of loans to Drexel Burnham Lambert, which sold participations	$ 90 million

Note: Where there are zero coupon bonds, the payoff value of the bond is used in the "Amount" column.

> **"The chief characteristic of a financing or refinancing that is handled through the securities market is its size, usually more than $100 million."**

office buildings on Maiden Lane and on Water Street in New York. The Fisher Brothers building was financed on the basis of a letter of credit from the Union Bank of Switzerland.

Moody's plans to issue its credit rating system this fall.

Salomon Brothers worked with American Express, Olympia & York and Fisher Brothers to obtain AA ratings for the securities on the New York office buildings. Drexel Burnham Lambert obtained a Baa rating from Moody's on securities issued by Las Colinas Corporation to finance land. Drexel Burnham Lambert also securitized $320 million of first mortgages on casino hotels in Las Vegas and in Reno.

Securitization of existing portfolios

For many years, financial institutions have sold income property loans to each other but in very small amounts compared with the number of mortgages originated. In recent years, tax considerations have become more important, particularly for mutual life insurance companies. The sale of a mortgage at a discount produces a tax loss that can be deducted against other tax gains.

Many of the savings and loan associations, in contrast to the major life insurance companies, do not have profits to be offset by tax losses so they are unwilling to sell mortgages at a loss.

continued

An exception to this was the sale of purchase-accounting mortgage portfolios which were sold in 1982-83 and where accounting regulations permitted thrifts to defer the losses.

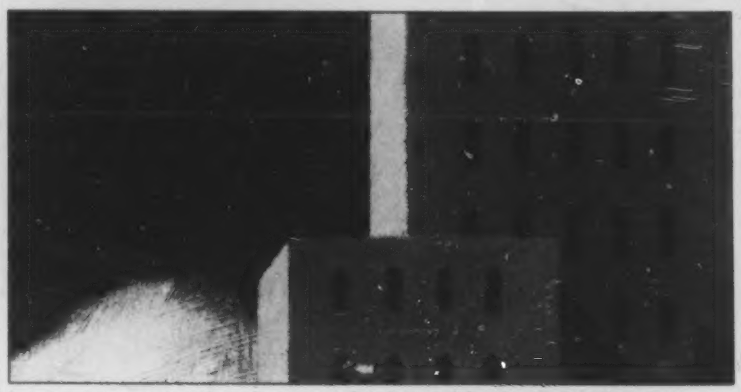
In addition to selling whole loans, financial institutions also sell participations in income property mortgages. All of these sales are privately placed, so we have no records of how much has been sold. (Chart 2 lists only two of the largest participation sales.)

If it were sold to the public, a participation would become a security that would have to be registered with the Securities and Exchange Commission (SEC). Most participations are considered a means of financing between parties who are accustomed to lending on income property mortgages. The mortgage documents may be retained by the seller or may be delivered to a custodian. Sometimes the seller retains a portion of the participation and sometimes it sells 100 percent.

Securities, on the other hand, are usually sold to a wider group of investors, although the majority of sales of securitized income property mortgages are privately placed. A prospectus or offering memorandum is usually prepared. Two types of securities issues have been used predominately in the income property field, the fixed-payment bond and the pass-through security.

Fixed-payment bond

When a life insurance company issues a fixed-payment bond, called a mortgage-backed bond in the prospectus, the issuer (usually a specially created subsidiary of the life insurance company) is assuring the bond buyers that interest and principal will be paid as scheduled. The life insurance company attempts to make sure that the money it receives from the mortgages will cover the payments to the bondholders, but the bondholders need not worry about the mortgages because the obligation of the life insurance company to pay the bonds is there regardless of mortgage performance.



The fixed-payment bond is a method of borrowing funds. The motivation of the life insurance company may be to do a better job of balancing its assets with its liabilities, or to raise money for the returns available through new investments, or to take advantage of an arbitrage situation.

Fixed-payment bonds were sold in the European market in the early part of 1985 because European investors were accepting lower interest rates than American investors. Furthermore, these issues, if sold outside the United States, do not have to be registered with the SEC. Registration is an additional cost and for mutual life insurance companies, it sometimes poses an accounting problem because the SEC requires that Generally Accepted Accounting Principles (GAAP) be used for domestic sales.

Last spring and summer, interest rates on the Euromarket were too high, comparable to other sources of money, to justify further sales of fixed-payment bonds overseas.

Prudential, New England Mutual, Connecticut Mutual, Phoenix Mutual and Mutual Benefit Life have sold commercial mortgage-backed bonds overseas. The bonds are sold in several classes. For instance, the first class might have a term of seven years, the second class 10 years and the third class might be a 15-year zero

Cronheim, the cornerstone of mortgage banking.

Established 1897

coupon bond. A sinking fund is created with each offering to provide for the redemption of the bonds on a *pro rata* basis. As soon as the earliest bond class is paid off, then the next class of bonds is partially redeemed each year until that class is paid. Salomon Brothers and First Boston were the major underwriters for fixed-payment bonds.

Collateralized mortgage obligation

The first commercial mortgage obligation (CMO) for income property mortgages, issued in August 1984, was based on Fannie Mae certificates swapped by a Minneapolis savings and loan association, as discussed hereafter. The only other CMO was issued by Penn Mutual Life Insurance Company which pledged 85 income property mortgages, with a value of $244 million and received $204 million. The CMO was divided into four classes of securities with the final class being a 20-year (approximately) zero coupon bond.

Pass-through securities

Unlike a fixed-payment bond or a CMO, which are borrowings, pass-through securities are used to sell mortgages. The life insurance companies have used the sale of pass-throughs to make their portfolios more liquid, to raise money for new investments, and, often, to create tax losses. The loss, of course, is only available if the mortgages are sold at a discount. In 1986, interest rates on commercial mortgages have been falling to the levels that were available in the 1970s, so that sales in order to create tax losses are increasingly rare.

The buyers of income property mortgage securities are usually unwilling to reunderwrite the mortgage loans, so often they have required that the sellers provide a limited form of recourse. The life insurance companies have carefully structured the recourse provisions so that sales treatment will still be accorded.

The recourse provision on the sale of pass-through securities is now fairly standard. If the mortgagor fails to pay principal or interest as required by the mortgage loan, the life insurance company will advance the scheduled payments. If the borrower has failed to pay three or more consecutive payments within 24 months, the life insurance company will repurchase the loan at par plus one month's interest. During the 24 months, the life insurance company may continue to advance payments, or act to foreclose the loan or take a deed in lieu of foreclosure.

In order to get the benefits of the yield curve (shorter term notes pay lower interest rates, at least in recent years), the pass-through security is often divided into pools. Each pool's term is different. Massachusetts Mutual divided 328 mortgages it sold into nine pools of pass-through securities, but the usual number of pools is much lower.

Five of the pass-through securities issues sold were rated by Standard & Poor's, based on the recourse provisions and the credit of the life insurance companies, not on the mortgages by themselves.

Purchase and swap programs for multifamily mortgages

Freddie Mac purchases multifamily mortgages under two programs, Plan A and Plan B. The most popular program, Plan B, pays cash for mortgages that have a 10- to 15- year term but are usually amortized over a 30-year period. Prepayment is forbidden for a minimum of 54 months after delivery to Freddie Mac. Plan A multifamily mortgages are purchased for cash or for Freddie Mac certificates and have terms from 10 to 30 years. Plan B mortgages may be assumed, but Plan A mortgages may not.

Plan A mortgages are included in a limited amount (not to exceed 5 percent) in securities issues for single-family mortgages. Plan B mortgages are pooled and pass-through securities called participation certificates are sold publicly. Freddie Mac provides an unconditional guarantee that there will be timely payment of interest at the coupon rate and that all principal payments will be collected and paid without offset or deduction. Payments of interest and of principal are made monthly.

The first pool of Plan B multifamily mortgage securities consisted of 568 mortgages for a total of $701 million. This was sold in August 1985 and was followed a month later by a sale of securities for $100 million in the

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Euromarket. Last March, Freddie Mac sold $800 million of Plan B mortgage securities within the United States.

Freddie Mac continues to buy Plan B mortgages and it is expected that it will continue to securitize them and sell them either domestically or overseas.

Both Fannie Mae and Freddie Mac have programs for exchanging their guaranteed certificates for multifamily mortgages, but Freddie Mac is not actively pursuing its multifamily swap program, which it calls the Guarantor program. Fannie Mae's program is its mortgage-backed securities (MBS) program, but it has completed relatively few multifamily transactions.

In 1984 and early 1985, Freddie Mac exchanged its certificates for multifamily mortgages from the Financial Corporation of America (FCA), a California thrift institution. Freddie Mac has also swapped certificates for mortgages with four smaller institutions, the total Guarantor multifamily volume being about $850 million.

Fannie Mae, under its MBS program, exchanged its certificates for $140 million of multifamily mortgages from Midwest Federal in Minnesota. After this swap took place in August 1984, Midwest used the certificates as security for a collateralized mortgage obligation. Fannie Mae's MBS program was used with Seamen's Bank for Savings in New York and last April, with Empire of America, a New York savings bank.

Role of the mortgage banker in securitization

Mortgage bankers have sometimes expressed concern that the income property mortgage market will become securitized, and the players in that market that emerge will be major lenders and securities firms, not mortgage bankers. The trends to date indicate that concern to be virtually groundless.

In the business of securitized originations, the transactions to date have been extraordinarily large. There seem to be several reasons why it may be a long time before the size of the securitized origination drops to the level (the $10 million to $50 million loan) where mortgage bankers control the financing. First, the fees on a securitization are significant, not only the fees for underwriting and sale, but also legal and accounting fees, credit support fees and servicing fees. Second, if the loan is one that a life insurance company will consider, it may be possible to obtain quicker decisions from a life insurance company than from a securities firm. The life insurance companies, for the mortgages they want, sometimes will "circle" an interest rate within a week after receiving the loan submission and subject to the receipt of supporting information. The securities firms, on the other hand, require full information before they will quote a rate. It may take 60 days or more for a securities firm to give a firm quote.

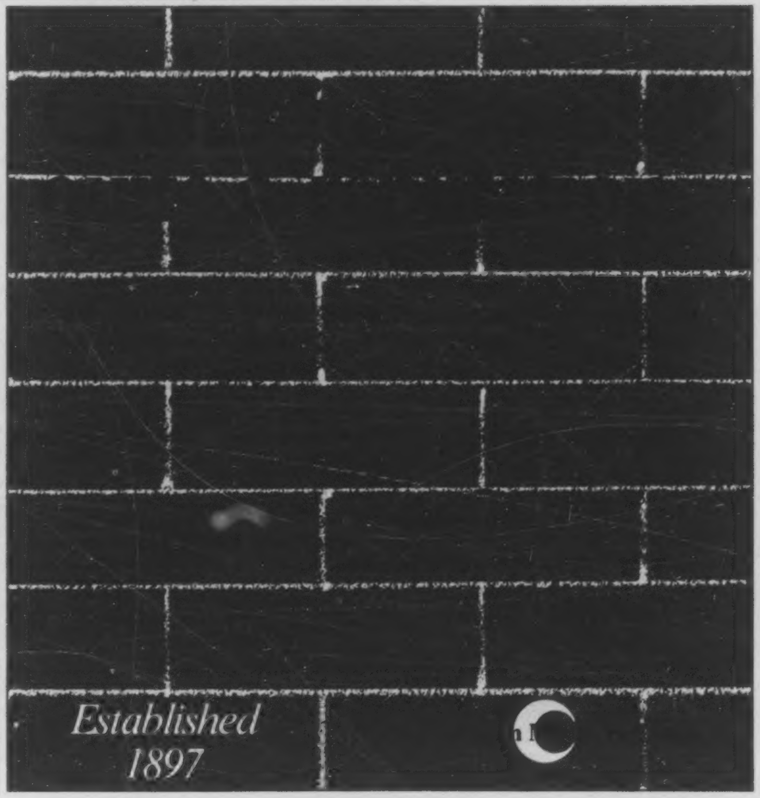
Some developers may be reluctant to have their deals securitized because once the security is issued, it may be more difficult to amend or change the scope of the deal. With a mortgagee familiar with the developer, more flexibility to changes may be possible.

On the other hand, the securities method may produce a considerably lower rate of financing for the borrower, particularly if the transaction has excellent credit behind it. The securities need not be limited to 75 percent of value.

In summary, for securitized originations, the mortgage banker will find that, for the immediate future, the securities firms will securitize only a few major-sized transactions.

In the field of securitization of existing portfolios, the mortgage banking firm may play a more active role, particularly for smaller life insurance companies and thrifts. It can help the institutions price their portfolios, find a buyer for individual mortgages and participations, and it can help the buyer with its due diligence. Moreover, in the multifamily field, the mortgage banker can originate mortgages for pooling and the sale of securities.

Last summer, securitization of income property mortgages was relatively quiet, due in major part to the fact that interest rates were low and the opportunities for new business were more remunerative than the purchase of existing mortgage portfolios. This will change because securitization is here to stay and the mortgage banking firms can play an important part. ☐



MORTGAGE MARKET TRENDS

In recent weeks, long-term interest rates have begun edging up, bringing an end to this summer's slide in rates that permitted fixed-rate mortgage levels to return to single digits. In particular, after dropping approximately 60 basis points from late July through late August to just under 7 percent, yields on 10-year Treasury securities have backed up by roughly 60 basis points to about 7.6 percent. This reversal in the direction of long-term interest rates has been fueled by the financial market's belief that economic growth may accelerate from the lethargic pace recorded in the first half of the year, that the outlook for inflation has worsened and that further accomodative moves by the Federal Reserve Board are, therefore, unlikely.

To be sure, the latest set of economic statistics do point to an improving economy. Boosted by a sizeable rise in durable goods orders, total new orders for manufactured goods in July rose by more than 2 percent, the first solid increase in orders this year. At the same time, while the August employment report showed a moderate increase by 200,000 jobs at all non-farm establishments, an increase of 20,000 jobs was recorded in the manufacturing sector, and this was accompanied by an increase in the average length of the work week in manufacturing to the highest level since January of this year. In addition, according to advance estimates, total retail sales in August rose by nearly 0.8 percent above the July sales levels—the largest monthly sales gain since May. And when these figures are combined with the 1.1 percent increase in the July index of leading economic indicators, the second largest of the year, the financial markets perceptions regarding the future course of monetary policy and interest rates appear to be justified.

A closer look, however, reveals that recent statistics exaggerate the strength of the rebound in economic growth. For example, the improvement in manufactured goods orders in July was due principally to a 4 percent rise in orders for durable goods. However, the bulk of this increase occurred in the defense category. Excluding defense, the durable goods orders increase was only 1 percent. Also, the increase of total employment in August came on the heels of a huge downward revision in the July employment figures of 130,000 jobs. Further, although the employment gain in the manufacturing sector last month was heartening in that it did signal a modest improvement in industrial activity, the August improvement pales in comparison to the loss of 100,000 jobs recorded in this important sector during the second quarter.

The rise in total retail sales in August, moreover, was centered in the automotive area, which received a strong one-time shot in the arm from cut-rate financing incentives. Excluding the auto sector, the August sales picture appears far less robust. Finally, the July rise in the index of leading economic indicators was centered primarily in the large rise in the money supply and in net business formations—two components of the index that have typically been unreliable indicators of the future direction of economic activity.

Undoubtedly, the latest batch of statistics suggests that a modest pickup in growth may be taking place. However, we continue to believe that slow to moderate growth lies ahead over the next several quarters.

The economy is still plagued with some fundamental weaknesses. The nagging trade deficit will limit gains in overall growth during the second half. Also, the Commerce Department's latest survey of business' capital spending plans for this year confirms the view that investment in plant and equipment will remain weak as long as capacity utilization remains low and improved prospects for growth abroad seem slim.

While there is no evidence to suggest that consumer spending is about to evaporate, neither are there reasons to believe that substantially increased consumer spending is around the corner. The personal saving rate remains low, consumer debt burdens are far from previous levels and real average weekly earnings declined throughout the summer. Further, the very success of auto financing incentives may adversely affect future non-auto sales, not to mention auto sales. Thus, a weakening in consumer purchasing going into 1987 is a possibility.

Moreover, the one sector of consistently strong activity throughout this recovery, housing, now appears to have settled down to a lower, albeit still healthy plateau. The combination of the age of the housing expansion (i.e., depletion of pent-up demand and pockets of severe regional weakness) has taken some of the steam out of housing construction and sales. Therefore, it seems unlikely that the housing sector can be expected to provide much in the way of added stimulus. Of course, it is common knowledge that overbuilding in the non-residential construction sector has already led to a pronounced drop in activity in that area.

Finally, the probable passage of the proposed tax reform legislation will probably exacerbate the existing weakness in investment spending, as the loss of the investment tax credit and cutbacks in depreciation allowances will act as an additional inhibiting factor. Reductions in the federal deficit next year will also act to limit overall economic growth in the short run.

In sum, it is MBA's belief that the odds continue to favor a continuation of modest economic growth, with little change in the underlying rate of inflation. Because Fed policy will continue to be guided by what the broad array of economic and financial indicators tell them about the strength and direction of economic growth, monetary policy is likely to remain in an accomodative posture and the interest rate environment should remain favorable.

Edison R. Zayas
Senior Economist
September 16, 1986

HOUSING ACTIVITY

RESIDENTIAL STRUCTURES, BY UNIT TYPE

(Units in thousands)

YEAR AND MONTH	HOUSING STARTS Actual Total	Actual 1-4 Units	Actual 5+ Units	Seasonally Adjusted Annual Rates Total	Seasonally Adjusted Annual Rates 1-4 Units	Seasonally Adjusted Annual Rates 5+ Units	PERMITS 17,000 ISSUING PLACES Actual Total	Actual 1-4 Units	Actual 5+ Units	Seasonally Adjusted Annual Rates Total	Seasonally Adjusted Annual Rates 1-4 Units	Seasonally Adjusted Annual Rates 5+ Units
1986												
FEB	107	71	36	2,001	1,317	684	109	68	41	1,808	1,155	653
MAR	151	104	47	1,960	1,305	655	152	99	53	1,834	1,150	684
APR	188	126	62	2,019	1,321	698	180	125	55	1,885	1,256	629
MAY	187	134	53	1,853	1,324	529	170	120	50	1,788	1,210	578
JUN	184	131	52	1,852	1,310	542	173	121	52	1,792	1,229	563
JUL	176	126	50	1,818	1,258	560	154	115	[illegible]	[illegible]	[illegible]	[illegible]
1985 TOTAL	1,741	1,165	576				1,733	1,077	657			
1984 TOTAL	1,750	1,206	544				1,682	1,065	617			
7 MONTHS												
1986	1,108	772	336				1,070	722	348			
1985	1,014	696	318				1,002	631	371			
1984	1,076	741	335				1,041	685	356			
1983	968	690	278				924	611	313			

RESIDENTIAL STRUCTURES BY REGION

(Units in thousands)

YEAR AND MONTH	STARTS Actual North East	Actual Mid-West	Actual South	Actual West	Seasonally Adjusted Annual Rates North East	Seasonally Adjusted Annual Rates Mid-West	Seasonally Adjusted Annual Rates South	Seasonally Adjusted Annual Rates West	PERMITS 17,000 ISSUING PLACES Actual North East	Actual Mid-West	Actual South	Actual West	Seasonally Adjusted Annual Rates North East	Seasonally Adjusted Annual Rates Mid-West	Seasonally Adjusted Annual Rates South	Seasonally Adjusted Annual Rates West
1986																
FEB	12	11	51	33	404	370	745	482	12	12	53	32	287	306	743	472
MAR	21	21	69	40	332	344	763	521	21	20	64	46	276	287	718	553
APR	29	32	75	51	324	365	796	534	29	33	69	49	302	333	727	523
MAY	28	28	78	53	266	251	813	523	29	31	62	49	277	301	687	523
JUN	30	36	70	49	277	306	764	505	28	30	66	50	274	286	728	504
JUL	30	35	65	46	285	[illegible]	711	[illegible]	31	30	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
1985 TOTAL	252	240	782	468					260	237	753	484				
1984 TOTAL	204	243	866	436					201	212	812	457				
7 MONTHS																
1986	164	173	470	302					164	167	436	304				
1985	133	132	471	278					147	132	446	277				
1984	106	140	556	275					110	124	516	291				
1983	92	118	537	221					89	101	511	223				

HOUSING ACTIVITY (Cont'd.)

	HOUSING SALES (Units in thousands)				VALUE OF NEW CONSTRUCTION PUT IN PLACE (Dollars in billions)				CONSTRUCTION STATUS (Units in thousands)					
	EXISTING HOUSES[1]	NEW HOMES			Seasonally Adjusted Annual Rate				Seasonally Adjusted Annual Rate Under Construction			Completions		
YEAR AND MONTH		Sold	Available For Sale	Months Supply at Current Rate	Total	1 Unit	2+ Units	Non-res.	Total	1-4 Units	5+ Units	Total	1-4 Units	5+ Units
1986														
FEB	218	59	342	5.9	225.1	94.8	29.8	100.5	1,110	638	472	118	76	42
MAR	277	89	331	4.5	221.1	95.7	30.8	94.6	1,099	627	472	133	92	41
APR	336	84	334	4.5	224.4	97.5	31.8	95.1	1,135	638	497	129	94	35
MAY	330	75	337	5.4	224.4	99.5	32.9	92.0	1,132	648	484	148	94	54
JUN	338	64	345	5.9	226.6	102.3	32.8	91.5	1,153	665	488	149	102	47
JUL$_p$	336	54	353	6.7	229	104.7	32.6	91.7	1,163	679	484	148	99	49
1985 TOTAL	3,214	688										1,703	1,167	534
1984 TOTAL	2,868	639										1,652	1,137	515
7 MONTHS														
1986	2,048	480										948	640	308
1985	1,832	416										929	627	302
1984	1,761	403										902	612	290
1983	1,597	380										675	494	181

LENDER ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED
By Type of Institution and By Unit Type

(Dollars in millions)

	TOTAL					1-4 UNITS				
YEAR AND MONTH	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
OCT	$36,525	$6,548	$14,014	$13,288	$2,675	$24,450	$6,104	$11,032	$7,208	$106
NOV	32,864	5,660	12,363	11,886	2,955	21,142	5,200	9,357	6,491	94
DEC	43,586	5,730	15,919	16,189	5,748	22,814	5,158	10,101	7,162	393
1986										
JAN	24,806	5,488	10,512	7,428	1,378	17,341	5,168	7,893	4,126	154
FEB	28,203	5,835	10,478	9,983	1,907	18,980	5,326	8,157	5,418	79
MAR$_p$	34,734	8,906	13,190	10,197	2,441	25,772	8,134	10,348	6,949	341
1985 TOTAL	369,343	68,065	145,372	127,873	28,033	241,474	62,658	109,286	68,224	1,306
1984 TOTAL	295,062	50,816	129,482	97,776	16,988	199,228	47,589	96,187	54,626	826
3 MONTHS										
1986	87,744	20,229	34,180	27,609	5,726	62,093	18,628	26,398	16,493	574
1985	66,722	12,621	26,703	23,026	4,372	42,999	11,594	19,227	11,985	193
1984	65,427	13,947	25,697	22,966	2,817	44,430	13,038	18,977	12,240	175
1983	52,965	14,395	17,422	18,322	2,826	38,693	13,520	13,444	11,577	152

LENDER ACTIVITY (Cont'd.)

LOANS CLOSED (Cont'd.)

(Dollars in millions)

YEAR AND MONTH	5+ UNITS Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	NONRESIDENTIAL Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
OCT	$2,694	$150	$1,456	$700	$388	$9,381	$294	$1,526	$5,380	$2,181
NOV	2,545	183	1,401	716	245	9,137	277	1,605	4,639	2,616
DEC	5,048	274	2,935	1,111	728	15,724	298	2,883	7,916	4,627
1986										
JAN	1,790	86	1,218	433	53	5,675	234	1,401	2,869	1,171
FEB	2,335	323	1,099	541	372	6,888	186	1,222	4,024	1,456
MAR	2,215	300	1,278	446	191	6,747	472	1,564	2,802	1,909
1985 TOTAL	28,034	2,396	15,604	7,262	2,772	99,835	3,011	20,482	52,387	23,955
1984 TOTAL	20,588	443	13,160	5,519	1,466	75,246	2,784	20,135	37,631	14,696
3 MONTHS										
1986	6,340	709	3,595	1,420	616	19,311	892	4,187	9,696	4,536
1985	5,079	584	2,776	1,307	412	18,644	443	4,700	9,734	3,767
1984	4,798	172	2,729	1,609	288	16,199	737	3,991	9,117	2,354
1983	3,040	191	1,589	1,050	210	11,232	684	2,389	5,695	2,464

LONG-TERM COMMITMENT ACTIVITY

By Type of Institution

(Dollars in millions)

YEAR AND MONTH	ISSUED DURING MONTH Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.	OUTSTANDING Total	Mtg. Bankers[9]	S&Ls	Banks[2]	Life Cos.
1985										
OCT	$29,039	$4,208	$16,134	$5,775	$2,922	$110,307	$12,436	$49,882	$29,100	$18,889
NOV	29,343	6,636	13,967	5,476	3,264	112,662	12,237	49,249	32,014	19,162
DEC	28,511	6,489	14,889	4,693	2,440	109,632	14,091	47,704	31,459	16,378
1986										
JAN	24,619	7,695	12,913	1,588	2,423	96,650	13,930	47,353	18,327	17,040
FEB	31,258	7,954	13,907	6,806	2,591	108,898	16,153	44,355	30,732	17,658
MAR	40,248	14,666	17,787	3,372	4,424	118,879	22,110	50,614	25,945	19,209
1985 TOTAL	323,085	59,986	170,763	60,635	31,701					
1984 TOTAL	258,986	44,893	146,184	47,065	20,844					
3 MONTHS										
1986	96,125	30,315	44,607	11,765	9,438					
1985	60,261	9,966	33,988	8,946	7,361					
1984	61,573	12,569	32,604	10,884	5,516					
1983	51,252	17,481	23,117	7,086	3,568					

MORTGAGE INSURANCE

(Units in thousands, Dollars in millions)

YEAR AND MONTH	APPLICATIONS RECEIVED (Units) Total	FHA[3]	VA	Private	LOANS INSURED Total Units	Total Amt.	FHA(203) Units	FHA(203) Amt.	VA Units	VA Amt.	Private Units	Private Amt.
1986												
FEB	211	136	25	50	97	6,594	45	2,773	18	1,242	34	2,579
MAR	305	211	33	61	115	7,752	57	3,477	23	1,621	35	2,654
APR	379	270	32	77	105	7,354	47	2,939	18	1,299	40	3,116
MAY	344	220	39	85	141	9,837	73	4,608	24	1,742	44	3,487
JUN	314	166	48	100	138	9,904	56	3,530	32	2,397	50	3,977
JUL	320	166	42	112	153	10,676	64	3,871	27	1,942	62	4,865
1985 TOTAL	2,194	902	251	1,041	1,261	83,305	338	19,784	192	13,046	731	50,475
1984 TOTAL	1,862	477	180	1,205	1,344	86,775	200	10,644	198	12,728	946	63,403
7 MONTHS												
1986	2,078	1,299	243	536	859	59,617	387	23,957	161	11,547	311	24,113
1985	1,231	490	122	619	675	44,004	159	9,147	94	6,293	422	28,537
1984	1,127	253	121	753	843	54,208	138	7,369	133	8,581	572	38,258
1983	1,144	528	170	446	640	37,739	209	10,359	138	8,700	293	18,680

SECONDARY MARKET ACTIVITY

(Dollars in millions)

YEAR AND MONTH	FNMA				FHLMC*				GNMA	
	Portfolio		Mortgage-Backed Securities		Comm. to Sell	Comm. to Buy	Mtg. Purc.	Mtg. Sold	Pass-Through Securities	
	Comm.	Purc.	Outstanding	Issued					Applications	Issued
1986										
FEB	$2,578	$1,159	$60,752	$2,978	$5,526	$6,044	$4,605	$4,268	$5,973	$5,006
MAR	1,917	1,410	62,310	2,260	7,213	7,128	5,318	5,900	14,853	5,059
APR	3,774	1,631	64,171	2,835	8,223	9,869	6,195	5,593	13,336	6,900
MAY	3,538	1,978	67,312	4,491	9,857	10,612	8,947	8,162	4,863	5,872
JUN	3,049	3,000	72,377	6,831	9,720	10,338	10,505	10,353	9,472	8,178
JUL[p]	3,270	3,343	76,197	6,106	n.a.	n.a.	n.a.	n.a.	14,246	10,226
1985 TOTAL	20,225	21,510	—	23,649	30,743	32,601	21,885	20,489	36,101	27,857
1984 TOTAL	21,007	16,721	—	13,546	30,921	32,846	22,952	21,376	70,280	50,496
7 MONTHS										
1986	19,441	13,709	—	29,446	45,419	49,296	39,279	37,576	72,846	46,539
1985	12,001	12,797	—	9,726	22,120	24,353	18,574	17,018	33,225	21,747
1984	12,093	10,411	—	6,949	10,564	11,108	8,271	7,308	22,256	17,589
1983	10,235	10,346	—	9,038	11,601	12,130	11,687	11,043	43,418	30,144

* FHLMC Year-to-date totals are for six months only.

INTEREST RATES AND YIELDS

YEAR AND MONTH	1- to 4-UNIT MORTGAGES							APARTMENTS[5]
	FHA OPINION SURVEY			FHLBB SURVEY		FNMA		
	FHA New[4]	CONVENTIONAL New	CONVENTIONAL Existing	CONVENTIONAL New	CONVENTIONAL Existing	1 Yr. ARM (1%/Yr.)	FRM Conv.	APT's
1986								
MAR	9.77%	10.06%	10.10%	10.50%	10.62%	9.04%	9.494%	11.09%
APR	9.80	9.99	9.99	10.27	10.37	8.49	9.300	10.84
MAY	10.07	10.32	10.33	10.22	10.15	8.70	9.663	10.81
JUN	9.98	10.38	10.39	10.15	10.20	8.60	10.050	11.62
JUL	10.01	10.28	10.32	10.30	10.26	8.29	9.813	12.02
AUG	n.a.	n.a.	n.a.	10.27	10.27	8.04	9.631	11.45

CURRENT SECONDARY MARKET YIELDS / SELECTED SECURITIES

YEAR AND MONTH	CURRENT SECONDARY MARKET YIELDS			SELECTED SECURITIES			
	GNMA[6]	FNMA[6]	FHLMC[6]	A-Rated[7] Utility	U.S. Government 10-yr.	U.S. Government 26-wk.	Prime Comm. Paper 90-119 Days
1986							
MAR	9.05%	9.23%	9.27%	9.41%	7.78%	6.57%	7.20%
APR	9.01	9.08	9.12	9.26	7.30	6.08	6.60
MAY	9.33	n.a.	n.a.	9.50	7.71	6.19	6.62
JUN	9.57	9.71	9.75	9.65	7.80	6.27	6.71
JUL	9.32	9.48	9.49	9.57	7.30	5.86	6.33
AUG	9.11	9.21	9.24	9.51	7.17	5.55	5.92

SPREADS (Basis Points)

YEAR AND MONTH	FHA New Minus A-Utility	GNMA Minus 10-Yr. Govt.	FNMA Minus 10-Yr. Govt.	FHLMC Minus 10-Yr. Govt.
1986				
MAR	36	127	145	149
APR	54	171	178	182
MAY	57	162	n.a.	n.a.
JUN	41	177	191	195
JUL	50	202	218	219
AUG	n.a.	194	204	207

NA—Not available; p—Preliminary

[1] From the National Association of Realtors "Existing Home Sales" series

[2] Mutual Savings Banks and Commercial Banks.

[3] FHA applications received includes the Direct Endorsement Program starting in 1984.

[4] Secondary market gross yields.

[5] Federal Home Loan Mortgage Corp. Existing Construction only.

[6] Securities for 0 to 30 day delivery.

[7] Prior to January 1984 this rate was for Aaa-rated New Issue Utility Bonds.

[8] Year-to-date seasonally adjusted series not calculated.

[9] 1985 data on mortgage bankers obtained from the HUD Survey of Mortgage Lending Activity.

MORTGAGE BANKING ACTIVITY

LONG-TERM MORTGAGE LOANS CLOSED[1]

YEAR AND MONTH	NOT SEASONALLY ADJUSTED									SEASONALLY ADJUSTED			
		1-4 Units				5+ Units							
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-[3] res.	Total[2]	1-4 Units	5+ Units	Non-[3] res.
1984													
JUL	$ 3,760	$ 3,330	$ 800	$ 530	$ 2,000	$ 0	$ 0	$ 0	$ 430	$3,530	$2,960	$ 0	$460
AUG	3,570	3,070	520	380	2,170	0	0	0	500	3,120	2,600	0	510
SEP	3,050	2,400	550	380	1,470	70	70	0	580	3,380	2,500	120	780
OCT	3,700	3,110	820	470	1,820	0	0	0	590	3,600	2,920	0	750
NOV	3,370	3,090	820	470	1,800	0	0	0	280	3,890	3,610	0	280
DEC	5,250	4,090	1,280	690	2,120	80	0	80	1,080	4,850	3,860	70	770
1983 Total	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1984 Total	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
12 MONTHS[5]													
1984	53,170	44,500	10,850	7,130	26,520	1,980	120	1,860	6,680				
1983	65,050	55,680	20,620	12,570	22,490	3,840	810	3,030	5,530				
1982	29,250	24,440	8,510	5,160	10,770	1,580	640	940	3,230				
1981	33,470	25,830	8,380	6,200	11,250	1,740	770	970	5,910				

COMMITMENT ACTIVITY: LONG-TERM MORTGAGE LOANS[1]

YEAR AND MONTH	COMMITMENTS DURING MONTH								OUTSTANDING COMMITMENTS END OF MONTH					
	To Borrowers				From Investors				To Borrowers			From Investors		
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.	1-4 Units	5+ Units	Non-[3] res.
1984														
JUL	$ 4,060	$ 2,940	$ 0	$1,120	$ 4,050	$ 3,580	$ 20	$ 450	$10,840	$ 70	$570	$9,870	$250	$1,570
AUG	2,920	2,630	0	290	4,220	3,380	10	830	7,430	40	500	7,730	210	1,600
SEP	2,910	2,640	30	240	2,760	2,400	80	280	7,350	300	500	7,460	480	800
OCT	3,910	3,240	0	670	4,550	4,090	30	430	7,660	170	540	8,400	370	740
NOV	3,430	2,820	0	610	3,880	2,760	170	950	7,460	40	690	6,940	270	1,050
DEC	5,490	4,090	430	960	4,850	3,910	80	860	7,850	100	750	7,810	280	1,170
1983 TOTAL	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1984 TOTAL	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
12 MONTHS[5]														
1984	50,100	41,420	510	8,170	55,550	43,820	3,160	8,570						
1983	81,070	67,740	4,310	9,020	79,450	64,240	5,770	9,440						
1982	47,800	36,760	3,330	7,710	46,740	34,380	3,960	8,400						
1981	36,700	30,170	1,200	5,330	44,700	30,410	1,740	12,550						

OUTSTANDING END OF MONTH INVENTORY[1]

YEAR AND MONTH		1-4 Units				5+ Units			
	Total	Total	FHA	VA	Conv.	Total	FHA	Conv.	Non-res.[3]
1984									
JUL	$8,870	$6,990	$1,480	$1,090	$4,420	$730	$0	$730	$1,150
AUG	7,070	5,520	1,060	740	3,720	640	0	640	910
SEP	7,390	5,490	1,010	680	3,800	640	0	640	1,260
OCT	8,060	6,350	1,190	870	4,290	600	0	600	1,110
NOV	8,010	6,280	1,190	850	4,240	590	0	590	1,140
DEC	6,840	6,090	1,500	980	3,610	170	0	170	580

MORTGAGE BANKING ACTIVITY (Cont'd.)

YEAR AND MONTH	COVERAGE[4]			SERVICING VOLUME[1]				NOTES PAYABLE[1] (End of Month Balances)			
	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non.[3] res.	Total	Comm. Paper	To Banks	To Others
1984											
JUL	55%	31%	91%	$421,420	$317,600	$63,980	$39,840	$41,960	$6,190	$12,710	$23,060
AUG	60	31	113	363,570	282,400	42,060	39,110	47,940	5,750	13,220	28,970
SEP	58	51	45	381,070	302,840	39,300	38,930	59,220	4,520	14,240	40,460
OCT	60	48	45	417,780	339,960	40,660	37,160	57,230	4,830	17,070	35,330
NOV	51	43	57	422,490	350,580	39,790	32,120	54,180	4,820	19,180	30,180
DEC	56	96	88	385,270	321,620	33,110	30,540	42,280	8,390	23,680	10,210

CONSTRUCTION AND LAND LOAN ACTIVITY[1]

YEAR AND MONTH	CONSTRUCTION LOANS CLOSED				DISBURSEMENTS DURING MONTH					END OF MONTH INVENTORY				
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans	Total	1-4 Units	5+ Units	Non-[3] res.	Land Loans
1984														
JUL	$790	$130	$210	$450	$280	$ 70	$10	$200	$180	$2,760	$ 900	$240	$1,620	$1,120
AUG	410	110	130	170	100	60	0	40	90	2,200	790	190	1,220	830
SEP	440	100	160	180	100	50	10	40	120	2,150	790	180	1,180	800
OCT	400	210	100	90	90	40	10	40	130	2,180	780	220	1,180	870
NOV	210	140	50	20	170	110	20	40	240	3,520	1,380	410	1,730	2,260
DEC	470	270	120	80	430	220	30	180	470	9,240	3,790	790	4,680	3,440

COMMITMENTS TO BORROWERS: AND LAND CONSTRUCTION LOANS[1]

YEAR AND MONTH	ISSUED DURING MONTH				END OF MONTH BALANCES			
	Total	1-4 Units	5+ Units	Non-[3] res.	Total	1-4 Units	5+ Units	Non-[3] res.
1984								
JUL	$1,730	$130	$ 60	$1,540	$4,090	$870	$470	$2,750
AUG	770	190	80	500	3,680	850	460	2,370
SEP	760	100	80	580	4,170	760	580	2,830
OCT	710	150	160	400	3,820	860	590	2,370
NOV	380	140	70	170	3,230	680	430	2,120
DEC	790	200	10	580	3,910	930	280	2,700

Notes: [1] All dollar amounts are in millions.

[2] Total is seasonally adjusted separately from components. Total, therefore, may not equal sum of parts.

[3] Series labeled non-residential are also inclusive of farm data.

[4] Percent coverage equals outstanding commitments received from investors divided by the sum of outstanding end of month inventory and outstanding commitments issued to borrowers, all multiplied by 100.

[5] Year-to-date seasonally adjusted series not calculated.